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No. ———

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

REPROSYSTEM, B.V., AND N. NORMAN MULLER,
Petitioners,

v.

SCM CORPORATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTION PRESENTED

Where fraud occurs in the course of face-to-face negotiations for the purchase of securities, must the defrauded party demonstrate the existence of a contract in order to state a cause of action under section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5?

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Petitioners, Reprosystem, B.V.,[1] and N. Norman Muller, respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this proceeding on February 2, 1984.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 727 F.2d 257 (2d Cir. 1984) and [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,667 (2d Cir. Feb. 2, 1984) and appears in the Appendix at 1a to 16a. The opinions of the District Court for the Southern District of New York appear in the Appendix at 17a to 89a; three

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[1]Reprosystem, B.V.'s parent company is Reprographex Antilles, N.V. Reprosystem, B.V. has no subsidiaries or affiliates.

of these opinions are reported at 522 F. Supp. 1257 (S.D.N.Y. 1981), 565 F. Supp. 4 (S.D.N.Y. 1982) and [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,207 (S.D.N.Y. June 30, 1981). An unreported judgment of the district court appears in the Appendix at 90a to 91a.

JURISDICTIONAL STATEMENT

The judgment of the Court of Appeals for the Second Circuit was entered on February 2, 1984. On April 19, 1984, Justice Marshall issued an Order extending the time for filing this petition to and including June 2, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (1982).

STATUTES AND REGULATIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), is set forth in the Appendix at 92a. Rule 10b-5, 17 C.F.R. § 240.10b-5 (1983), promulgated thereunder by the Securities and Exchange Commission ("SEC"), is set forth in the Appendix at 92a to 93a.

STATEMENT OF THE CASE

Petitioner Reprosystem, B.V., a Netherlands corporation, was incorporated by petitioner N. Norman Muller and others to purchase the shares and assets of six wholly-owned subsidiaries of respondent SCM Corporation. These six companies ("the companies") were operated by the International Group of SCM's Business Equipment Division and were engaged in the business of marketing, leasing and servicing office copiers, paper and toner throughout Western Europe, the Middle East and Africa.

A. SCM Decides to Sell Shares and Assets of the Companies

Late in 1975 SCM's principal officers, including Paul Elicker, SCM's President, Chief Executive and Chairman

of SCM's Board of Directors, and Herbert Egli, the Vice President-Finance and Controller of SCM, decided to sell the companies primarily because of projections of their decreasing profitability. 522 F. Supp. at 1260, App. at 19a.[2] Mr. Muller learned of this decision through a broker and in April and May 1976 discussed the matter with high-ranking officials of SCM including Mr. Elicker, Frank DeMaio, Vice President and General Manager of SCM's International Group, and William Rodich, President of SCM's Business Equipment Division.

By a letter of May 7, 1976, Mr. Muller offered to pay a total of $9 million for the companies. Mr. Rodich responded that Mr. Muller's letter provided the basis for negotiations, which were held in August and September 1976.

During these negotiations, Mr. Rodich prepared memoranda that contained thirteen points essential to SCM.[3] Mr. Muller agreed to these points and, by mid-September, the parties had reached an agreement in principle on the sale of the companies to Mr. Muller. Under this agreement, as of August 31, 1976, the business was to be operated in its ordinary course by SCM for the account and benefit of Mr. Muller. App. at 22a, 27a.

On September 16, 1976, SCM's Board of Directors approved the agreement in principle and authorized its public announcement. On September 28, 1976, SCM issued a press release which stated that

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[2] This opinion of the district court is reported at 522 F. Supp. 1257 and is reproduced in the Appendix at 17a to 68a. Citations to this opinion in petitioners' statement of facts will be in form "App. at ——."

[3] These memoranda are reproduced in the appendix to the district court's opinion. App. at 67a to 68a.

> SCM Corporation has reached an agreement in principle to sell its office copier service organizations in the United Kingdom, France, Germany, Switzerland and Belgium and its distribution operations covering Europe, the Middle East and Africa to a company controlled by N. Norman Muller, a private investor.[4]

App. at 24a. On September 30, 1976, SCM reported the agreement in principle in its Form 10-K filed with the SEC. App. at 24a.

Following the agreement in principle there occurred a period of intense negotiation and drafting. It was understood by all concerned throughout this period that the companies were being operated by SCM for the benefit of Mr. Muller. App. at 29a to 30a. By December 15-16, 1976, 16 drafts of the contract had been produced by SCM's counsel, the New York law firm of Sullivan & Cromwell. A meeting was then held at the request of Mr. Rodich, SCM's principal negotiator, to conclude the discussions. At this meeting two drafts, one a "global" agreement and the other a prototypical agreement for the sale of the shares of one of the companies, were discussed page by page.

At the conclusion of the meeting on December 16 no open terms remained, "[t]he negotiators were released, and adieus, season's greetings and congratulations were exchanged." App. at 32a. Mr. Rodich escorted Mr. Muller to Mr. DeMaio's office and advised Mr. DeMaio that the meeting had been successfully completed. As found by the district court, the import of this meeting of Mr. Rodich, Mr. Muller and Mr. DeMaio was to acknowledge the transfer of power. App. at 32a. Mr. Rodich also took Mr. Muller to Mr. Egli's office and advised Mr. Muller that Mr. Egli would finish up the transaction since Mr. Rodich

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[4] This announcement was reported in the New York Times, the Wall Street Journal, and on the Dow Jones ticker tape, among other places.

was about to be reassigned to Baltimore to serve as president of another SCM division.

On December 27, 1976, counsel for SCM provided final copies of the global agreement and the agreements for the purchase of the securities of four of the six companies; shortly thereafter, final documentation for the purchase of the assets of the two remaining companies was furnished by SCM. App. at 35a. As found by the district court, these documents constituted written agreements between the parties on all material terms relating to the sale, and it was so understood by all those involved as of the morning of December 31, 1976. App. at 35a.

B. December 31, 1976—SCM Decides to "Kill the Deal"

On December 31, 1976, Mr. Egli reviewed the final documents relating to the sale. In the course of this review, Mr. Egli began to give serious thought to backing out of the agreement. In notes made at the time, Mr. Egli set forth the "alternatives" he believed were open to SCM, the thrust of which was, as stated in the notes, to "[k]ill [the] deal."[5] Mr. Egli feared that the "deal" which had been struck was, in his words, "good for Muller not good for SCM." App. at 37a.

Mr. Egli discussed these matters with SCM President Elicker and SCM Vice President-Administration Hall on January 4, 1977, discussions which led to the district court's finding that "in January the responsible officers of SCM reached a conclusion to terminate the transaction with Muller." App. at 43a.

C. January-February 1977—SCM Fraudulently Fails to Disclose Its Decision to "Kill the Deal"

Despite the fact that its decision to kill the deal had been made, SCM continued to negotiate—in bad faith—

[5] The alternatives as stated by Mr. Egli in his notes are reproduced in the opinion of the district court. App. at 37a.

with Mr. Muller. SCM raised one new or previously-resolved issue after another, thereby prolonging the negotiations and making it more difficult for Mr. Muller to close the deal. During this period, SCM never disclosed that it had already decided to back out.

SCM began by demanding interest on the purchase price dating back to August 1976, a demand which the district court expressly found to be an "afterthought."[6] App. at 41a. SCM also requested, for the first time, evidence of Mr. Muller's capacity to pay the cash required at closing.

SCM sought a substantial increase in the purchase price and the attendant cash required to close, the latter amount having remained steady at $4.25 million between August and December. This increase was based on: (1) the recalculation by SCM of certain accounts receivable; (2) approximately $145,000 resulting from SCM's demand for interest on the purchase price, and (3) the request by SCM for an additional $540,000 due to an inter-company transfer.[7] SCM also withdrew from its

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[6] At the same meeting Mr. Egli announced his intention to visit the subsidiaries, a trip which the district court found was never satisfactorily explained by Mr. Egli either at the time or at trial. Mr. Egli insisted on making this trip over Mr. Muller's objection that it made more sense to accelerate the paperwork and complete the transaction. App. at 38a to 39a.

As found by the district court, Mr. DeMaio, too, objected to the trip and raised his objection with President Elicker but was overruled. App. at 39a. The district court further found that immediately after Mr. Egli's trip to Europe, Mr. DeMaio was informed by the European managers of the companies that Mr. Egli, during his trip, had indicated serious doubts regarding completion of the transaction. App. at 39a.

[7] The work papers regarding this transfer were never made available to Mr. Muller and the transfer, according to the district court, was never satisfactorily explained by SCM. App. at 40a. Nonetheless, Mr. Muller agreed to all of the price increases demanded by SCM except for the increase representing interest on the purchase price.

previous undertaking not to compete with the companies in the copier field.

SCM also took action inconsistent with the agreement in principle that SCM would operate the companies in the normal course of business and for the benefit of Mr. Muller. Contrary to this understanding, SCM reduced the leasing of new equipment, a mainstay of the companies' business. Mr. Egli single-handedly—and in secrecy—conducted critical negotiations in Europe with a likely supplier of new "plain paper" copying equipment to the companies, having refused Mr. Muller's request to accompany him.[8] Finally, upon Mr. Egli's return from Europe and without warning, Mr. Egli fired Mr. DeMaio—directing that he be escorted out of the building—and also fired the companies' other New York administrators and their secretaries. All of this was done without discussion with Mr. Muller or any prior notice to him, despite the fact that continuity of management had been a requisite of Mr. Muller to which SCM had agreed since early in the negotiations. Although SCM advanced certain reasons for the firing of Mr. DeMaio, the district court found them to be "pretextual, and therefore . . . significant evidence that Egli indeed sought to kill the deal." App. at 42a.

Summarizing the events of January and February 1977, the district court found

> that SCM's financial interest required that the sale not go forward, that Egli realized that fact, that the actions taken in January, 1977 by Egli on behalf of SCM had the effect of slowing down the signing and killing the deal, and that a specific plan for disposi-

[8] Throughout the negotiations with SCM, Mr. Muller had continually advocated the expansion by the companies into "plain paper" copying, which he believed to be essential to the continuation of the companies' business. This expansion, which was resisted by SCM's highest officials, was also favored by SCM managers such as Mr. DeMaio and ultimately proved to be of great financial benefit to the companies.

> tion of each corporation was evolved, contrary to the Agreement in Principle and the Final Drafts.

App. at 43a. However, not until February 4, 1977 did SCM inform Mr. Muller of its decision to "kill the deal". Within a short time after ending talks with Mr. Muller, SCM sold five of the companies individually to other purchasers[9] for profits several million dollars greater than it would have realized if the transaction with Mr. Muller had been completed.

D. Opinions Below

On November 22, 1977, Reprosystem[10] brought this action against SCM, seeking to recover damages arising from, *inter alia*, SCM's breach of contract and its violation of antifraud provisions of the federal securities laws.

In its judgment of June 30, 1981, the district court held that the parties had agreed in December 1976 upon all material terms of a contract for the sale of the shares and assets of the six companies to petitioners. The dis-

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[9] On January 20, SCM issued a press release stating that it felt free to pursue "other alternatives" to a sale of the shares and assets of the companies to Mr. Muller. App. at 42a. At least as early as January 25, President Elicker wrote to a potential alternate buyer. (Plaintiff's Exhibit 177)

SCM signed contracts for the sale of five of the companies on the following dates:

United Kingdom	May 6, 1977
Switzerland	May 20, 1977
France	June 22, 1977
Germany	November 3, 1977
Belgium	January 19, 1978

The sixth company was liquidated.

Both the separate disposition of each company and the liquidation of SCM's investment in the companies were alternatives described by Mr. Egli in his notes made at the time of his review on December 31, 1976. *See supra* at 5.

[10] An amended complaint was filed by Reprosystem and Mr. Muller on November 17, 1978.

trict court held that SCM breached the contract as well as its duty of good faith negotiation and performance.[11]

Turning to petitioners' securities fraud claims, the district court ruled that under the "sale of business" doctrine, the federal securities laws did not apply to the sale by SCM of the shares of four of the companies to petitioners.[12] However, the court did expressly take note of SCM's "failure to disclose the fact of a decision to 'kill the deal' " and emphasized its concern that "[w]ere the federal securities laws applicable, this omission would require further analysis." App. at 50a.[13]

On appeal, the court of appeals reversed the district court's holding that a contract existed between the parties. With respect to the securities fraud claims, the court of appeals noted its then-recent rejection of the sale of business doctrine. However, it ruled that because there was no contract between the parties for the purchase of securities, petitioners could not recover for securities fraud.

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[11] The court held that petitioners were entitled to damages as measured by SCM's unjust enrichment from profits received from the companies during the parties' negotiations. In a separate opinion and judgment, the district court awarded petitioners $1.062 million in damages arising out of SCM's breach of contract. 565 F. Supp. 4, App. at 89a, 90a.

[12] Subsequent to the district court's judgment, the Court of Appeals for the Second Circuit rejected the "sale of business" doctrine. *See* Golden v. Garafalo, 678 F.2d 1139 (2d Cir. 1982).

[13] At trial, petitioners alleged that SCM had also fraudulently overstated the assets and the income of the companies during the parties' negotiations. The district court found no fraudulent intent with regard to these misstatements. App. at 50a. Petitioners do not raise these allegations of fraud before this Court.

REASONS FOR GRANTING THE WRIT

I. THE ISSUE RAISED BY THIS PETITION IS RECURRING AND IMPORTANT TO THE INTEGRITY OF NEGOTIATIONS FOR THE PURCHASE OF SECURITIES

The court of appeals grounded its holding that petitioners could not recover damages under the federal securities laws on its conclusion that they "were not and do not claim to be actual purchasers or sellers of SCM stock." 727 F.2d at 265, App. at 15a. Consequently, "they do not satisfy the 'purchase or sale' requirement of *Birnbaum v. Newport Steel*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952)." *Id.*, App. at 15a.

Significantly, the court of appeals did not discuss or cite this Court's decision in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). In *Blue Chip Stamps*, the Court found that offerees of a stock offering made pursuant to an antitrust consent decree did not have standing to maintain a private cause of action for money damages where they had not purchased any of the offered shares. The Court reasoned that, in the context of the public securities markets, this rule was necessary to avoid unlimited liability to an unlimited number of non-purchasing plaintiffs, whose claims would be difficult to disprove.

At the same time, the Court in *Blue Chip Stamps* recognized the existence of a second universe of cases—involving individually negotiated transactions and privity of dealing—where the considerations which led to this holding do not apply.[14] Such cases pose none of the dan-

[14] That such cases were recognized as a separate universe by the *Blue Chip Stamps* majority is also implicit in the fact that this category of cases does not fall into any of the "[t]hree principal classes of potential plaintiffs" which the *Blue Chip Stamps* majority noted were barred from standing by its holding, *viz.*, (1) "potential purchasers of shares, either in a new offering or on

gers, such as an unlimited class of plaintiffs, speculative damages, and "strike" suits, which were of such concern in *Blue Chip Stamps.* Indeed, as the majority in *Blue Chip Stamps* acknowledged, under the common law a contract has never been viewed as a prerequisite to an action for fraud in the context of face-to-face negotiations. *See* 421 U.S. at 744-45.

Through review of this case, this Court can make explicit the logical limits of *Blue Chip Stamps* by holding that where fraud occurs in the course of face-to-face negotiations for the purchase of securities, the defrauded party has standing to sue under section 10(b) and Rule 10b-5.[15] Such a holding will give effect to Congress' desire in enacting the antifraud provisions of the securities laws to prevent fraud in this kind of securities transaction, without fostering vexatious or unfounded litigation.

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the Nation's post-distribution trading markets, who allege that they decided not to purchase because of an unduly gloomy representation or the omission of favorable material which made the issuer appear to be a less favorable investment vehicle than it actually was," (2) "actual shareholders in the issuer who allege that they decided not to sell their shares because of an unduly rosy representation or a failure to disclose unfavorable material," and (3) "shareholders, creditors, and perhaps others related to an issuer who suffered loss in the value of their investment due to corporate or insider activities in connection with the purchase or sale of securities which violate Rule 10b-5." *See* 421 U.S. at 737-38.

[15] As the court of appeals in this case observed, defrauded parties do have standing under the federal securities laws if they have entered into a contract to purchase securities. *See* 727 F.2d at 265, App. at 15a to 16a. *Accord* Threadgill v. Black, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,402 (D.C. Cir. Mar. 27, 1984).

A. The Reasons for Not Finding Standing to Sue for Fraud in Uncompleted Transactions in the Securities Markets Do Not Exist With Respect to Fraud in Face-to-Face Negotiations for the Purchase of Securities

In *Blue Chip Stamps* the Court recognized that "[t]he *Birnbaum* rule undoubtedly excludes plaintiffs who have in fact been damaged by violations of Rule 10b-5, and to that extent it is undesirable." 421 U.S. at 743. The Court was concerned, however, with the problems of proof inherent in the situation of a nonpurchasing plaintiff; it feared conferring standing upon a limitless class of putative plaintiffs seeking undocumented damages. The Court noted that private actions under Rule 10b-5 provided a singular opportunity for bringing "strike" suits, cases with "settlement value to the plaintiff out of any proportion to [their] prospect of success at trial. . . ." *Id.* at 740. The Court also expressed a fear of "throw[ing] open to the trier of fact many rather hazy issues of historical fact the proof of which depended almost entirely on oral testimony." *Id.* at 743.

While these fears may have been well founded in cases involving fraud in the securities markets, they are not valid in face-to-face negotiations for the purchase of securities. In that context, "strike" suits are unlikely, if not altogether impossible. Parties to such negotiations are known to one another and, indeed, have voluntarily chosen to deal with one another. The number of such cases, and hence the number of potential plaintiffs, is necessarily limited. The purchaser in an individually negotiated transaction does not have the leverage of a potential class action. Most importantly, the correspondence and conduct of the parties over a period of time eliminate the problems of proof and documentation of damages that were of concern in *Blue Chip Stamps*.

Such cases thus do not present the spectre, seen by both the majority and concurring opinions in *Blue Chip Stamps*, of affording standing to a legion of "bystanders to the securities marketing process" waiting on the sidelines for the prices of stocks to rise in order to seek a "largely conjectural and speculative recovery in which the number of shares involved will depend on the plaintiff's subjective hypothesis." *See* 421 U.S. at 735, 747; *id.* at 758-59 (Powell, Stewart & Marshall, JJ., concurring). In short, "the very necessity, or at least the desirability, of fashioning unique rules of corroboration and damages" for open market transactions, *see id.* at 744, is altogether absent in cases involving face-to-face negotiations.[16]

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[16] The majority opinion in *Blue Chip Stamps* also referred to the legislative history of section 10(b) and the language of the statute. Both of these aspects of that opinion deserve further analysis.

The majority in *Blue Chip Stamps* noted the SEC's unsuccessful attempts in 1957 and 1959 to have Congress amend section 10(b) to broaden its coverage. *See* 421 U.S. at 732. This aspect of the legislative history had not been suggested or briefed by any of the parties. The majority opinion apparently relies only upon a memorandum prepared in 1959 by the staff of the Senate subcommittee which simply summarizes the arguments of the SEC in favor of the amendment and the arguments of the securities industry against it. *See* SEC Legislation, Hearings on S. 1178-1182 Before a Subcomm. of the Senate Comm. on Banking & Currency, 86th Cong., 1st Sess., 367-68 (1959).

The broad language of the statute, which provides antifraud coverage "in connection with" purchases or sales of securities, was briefly discussed by the Court. *See* 421 U.S. at 733-34 & n.5. Its narrow reading of the statute, rejected by the *Blue Chip Stamps* dissent, *see id.* at 761-71 (Blackmun, Douglas & Brennan, JJ., dissenting); *see also* Eason v. Gen. Motors Acceptance Corp., 490 F.2d 654 (7th Cir. 1973), *cert. denied*, 416 U.S. 960 (1974) (Stevens, J.), was prompted at least in part by the majority's fear that the broader construction called for by the plain language of the statute might "provide a cause of action, not to purchasers and sellers of securities, but to the world at large." 421 U.S. at 733 n.5. Although this may be a valid concern with respect to

This last point is recognized in *Blue Chip Stamps* itself. Noting that there is "certainly" a relationship between the common law tort of misrepresentation and deceit and a claim of fraud under Rule 10b-5, the Court observed that "it has long been established in the ordinary case of deceit that a misrepresentation which leads to a refusal to purchase or to sell is actionable in just the same way as a misrepresentation which leads to the consummation of a purchase or sale. *Butler v. Watkins*, 13 Wall. 456 (1872)." 421 U.S. at 744. The Court declined to apply this rule, however, because the facts of the case before it were so markedly different from those in which the common law rule evolved.

In support of its comparison, the Court discussed at length the facts of *Butler* in which the plaintiff alleged that defendant had fraudulently professed an intent to enter into an agreement, while having no intention of doing so. Careful note was taken that the parties in *Butler* "met with one another in New Orleans, that one presented a draft agreement to the other, and that letters were exchanged relating to that agreement." *Id.* at 745. The Court further noted that the parties "had concededly been engaged in the course of business dealings with one another, and would presumably have recognized one another on the street had they met." *Id.*

This situation—"the typical fact situation in which the classic tort of misrepresentation and deceit evolved"—was viewed as "light years away" from the stock market transactions with which the Court was concerned in *Blue Chip Stamps. Id.* at 744-45. It is, however, precisely the situation in this case. Indeed, far from presenting the danger of a case-by-case erosion of *Blue Chip Stamps, see id.* at 755, this case typifies those cases involving face-to-face negotiations factually similar to those in

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transactions in the securities markets, this concern is unfounded in cases typified by the negotiated transaction in which petitioners engaged.

Butler. In view of this similarity, the logic of *Blue Chip Stamps* calls for a finding of standing in this case.[17]

B. Compelling Reasons Exist to Apply Section 10(b) and Rule 10b-5 to Face-to-Face Negotiations for the Purchase of Securities

Apart from the logic of *Blue Chip Stamps*, there are compelling reasons to apply section 10(b) and Rule 10b-5 to face-to-face negotiations for the purchase of securities.

The interest which petitioners seek to vindicate comes within the fundamental congressional purpose in enacting section 10(b), *i.e.*, to require full disclosure in transactions involving securities.[18] The coverage of the antifraud provisions of the securities laws is not limited to instruments traded at securities exchange. Thus, in *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 10 (1971), this Court held the securities

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[17] The Court in *Blue Chip Stamps* also noted the accumulation of cases applying the *Birnbaum* rule. 421 U.S. at 737. However, as Judge, now Justice, Stevens pointed out in Eason v. Gen. Motors Acceptance Corp., at the time *Birnbaum* was decided, "the rule . . . was thought to relate only to public sales of securities. . . ." 490 F.2d at 658. Thus, neither *Birnbaum* nor its progeny had occasion to address the question whether that rule should be applied to a private, negotiated transaction.

[18] *See, e.g.*, Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477 (1977). In Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972), this Court stated that Rule 10b-5 prohibits "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person," and held that the proscriptions under section 10(b) and Rule 10b-5 "are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive." Furthermore, as the Court has repeatedly recognized, Congress intended that the "securities laws combating fraud should be construed 'not technically and restrictively, but flexibly to effectuate [their] remedial purposes.'" Herman & MacLean v. Huddleston, 103 S. Ct. 683, 690 (1983), quoting SEC v. Capital Gains Research Bureau, 375 U.S. 180, 195 (1963); Blue Chip Stamps, 421 U.S. at 748; Affiliated Ute Citizens, 406 U.S. at 151.

laws applicable to a negotiated transaction in securities, stating that section 10(b) applies regardless of whether the transaction is conducted through an organized market. The antifraud provisions have "always been understood to apply to transactions in shares of close as well as publicly held corporations and to negotiated as well as market sales and purchases of shares." *Golden v. Garafalo*, 678 F.2d 1139, 1446-47 (2d Cir. 1982). Indeed, by the very act of "choosing to deal in stock, the parties may have created an expectation, deserving of some consideration, that the securities laws would apply." *Daily v. Morgan*, 701 F.2d 496, 503 (5th Cir. 1983).[19]

The comprehensive protection of the federal securities laws is essential to preserve the integrity of individually negotiated stock transactions. In the context of face-to-face negotiations there are numerous opportunities for misrepresentations to occur, many of which are not present in exchange transactions. Negotiations can be arduous and expensive. Vast amounts of capital may be at risk. These transactions are frequently national or, as in this case, international in scope. Regardless of whether the parties reach a contract, federal securities laws coverage—and concomitant federal jurisdiction—are essential to insure the integrity of the negotiating process.

In fact, there are important reasons supporting a federal private right of action for fraud in a negotiated transaction that are not applicable to transactions in the securities markets. Many federal securities laws, such as

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[19] As Judge, now Justice, Stevens stated in Eason v. Gen. Motors Acceptance Corp., 490 F.2d at 659, "a formal purchaser-seller limitation" in all circumstances is not consistent with the overriding purposes of the 1934 Act. "The emphasis on the injured party's status as an investor indicates that the protection of the rule extends to persons who, in their capacity as investors, suffer significant injury as a direct consequence of fraud in connection with a securities transaction, even though their participation in the transaction did not involve either the purchase or the sale of a security." *Id.*

those requiring the preparation of prospectuses and the filing of registration statements, provide substantial protection to purchasers of stock in securities markets which is often unavailable to those who purchase stock in negotiated transactions. The SEC also plays a far more active policing role in securities markets than it could possibly play in negotiated purchases or sales of stocks.

While execution of a contract is one means of obtaining protection, negotiating parties who fail to achieve a contract have no federal securities law protection against fraud in the negotiation process.[20] Indeed, federal protection is particularly necessary where, as here, petitioners were prevented from concluding a contract by the very fraud which is the subject of their federal securities law claim. *Cf. United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 868 (1975) (Brennan, Douglas & White, JJ., dissenting) ("Congress contemplated concurrent state and federal regulation in enacting the securities laws.").

For all of these reasons, Rule 10b-5 should apply to face-to-face negotiations for the purchase of a security regardless of whether a contract is formed. Accordingly, and contrary to the holdings of the courts below, petitioners are entitled as a matter of federal law to full consideration of their claim that they were defrauded by respondent SCM in the course of negotiations for the purchase of securities.[21]

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[20] Indeed, failure to extend standing to cover negotiations for the purchase of securities would be tantamount to saying that a negotiating party is free, under federal law, to commit any fraud it chooses during negotiations provided it breaks off negotiations at any time prior to entering into a contract.

[21] In particular, should this Court conclude that the courts below erred in denying standing, petitioners would argue on remand that respondent's fraudulent concealment of its intent to kill the deal amounted to a violation of Rule 10b-5.

II. THIS PETITION SHOULD BE GRANTED BECAUSE IT PRESENTS THE LOGICAL NEXT STEP AFTER *VISTA RESOURCES, INC. v. SEAGRAVE CORP.*

This Court recently granted the petition for certiorari filed in *Vista Resources, Inc. v. Seagrave Corp.*, 52 U.S.L.W. 3827 (U.S. May 14, 1984) (No. 83-1084). *Vista Resources* concerns the validity of the "sale of business" doctrine, under which some courts of appeals have held the federal securities laws inapplicable to sales of large blocks or all of the stock of a business.

The question presented in *Vista Resources* is whether a privately negotiated sale of the stock of a business is a transaction covered by the federal securities laws. This case raises a closely related issue: whether a defrauded party to such private negotiations must demonstrate the existence of a contract in order to sue under the anti-fraud provisions of the securities laws. Because of the close relationship between these issues, it may be desirable to grant the petition in this case and hear both issues on a consolidated or companion basis.

In any event, should the Court hold in *Vista Resources* that the anti-fraud provisions of the securities laws do apply to such transactions, this case provides the logical next step in the development of the law. The reasons why the sale of business doctrine should be rejected are the very reasons why standing should be found in this case, and turn on Congress' intent that a wide range of transactions involving purchases and sales of securities should be covered by the federal securities laws. *See* discussion *supra* at 15-16. Thus, at a minimum, in the event the Court decides not to grant this petition for certiorari at this time, it should hold this petition pending its ruling in *Vista Resources.*

CONCLUSION

Because this petition raises a recurring issue of considerable importance to the integrity of negotiations for the purchase or sale of securities, a writ of certiorari should issue to review the judgment of the Court of Appeals for the Second Circuit.

Respectfully submitted,

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June 1, 1984

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No. ———

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

REPROSYSTEM, B.V., AND N. NORMAN MULLER,
Petitioners,

v.

SCM CORPORATION,
Respondent.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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APPENDIX A

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

No. 1228, Dockets 83-7011, 83-7067

REPROSYSTEM, B. V., and N. NORMAN MULLER,
Plaintiffs-Appellees, and
Cross-Appellants,

v.

SCM CORPORATION,
Defendant-Appellant, and
Cross-Appellee.

Argued June 2, 1983

Decided Feb. 2, 1984

Before KAUFMAN, PRATT and GIBSON *, Circuit Judges.

GEORGE C. PRATT, Circuit Judge:

Defendant SCM Corporation appeals from a judgment of the United States District Court for the Southern District of New York, Robert W. Sweet, *Judge*, awarding $1,062,000 in damages to plaintiffs Reprosystem, B.V., a Netherlands corporation, and N. Norman Muller, a New York resident. 565 F.Supp. 4. The trial court found that SCM was contractually obligated to sell its six foreign subsidiaries to plaintiffs, that SCM breached the claimed contract of sale, and that even though plaintiffs would not have been able to perform the contract they were nevertheless entitled to breach-of-contract damages measured by SCM's "unjust enrichment" in the form of profits received from the subsidiaries during the period

* Honorable Floyd R. Gibson, of the United States Court of Appeals for the Eighth Circuit, sitting by designation.

of negotiations between the parties. On appeal, SCM contends that there was no contract because the parties intended not to be bound unless and until a formal written contract was executed, and that none ever was. SCM further contends that there was no basis, legal or equitable, for an award of damages. Plaintiffs have cross-appealed, claiming that the district court's finding that plaintiffs were unable to perform the contract was clearly erroneous, and therefore, that they are entitled to the entire profit SCM received from its subsequent sale of the subsidiaries to others. Plaintiffs also challenge Judge Sweet's dismissal of their securities fraud and promissory estoppel claims. On the main appeal we reverse the district court's conclusions that the parties were bound by a contract and that SCM was enriched unjustly; on the cross-appeal, we affirm its dismissal of the promissory estoppel and securities fraud counts.

I.

We first review the facts pertinent to our resolution of the appeal and cross-appeal. A more extensive exposition of the facts can be found in the district court's opinion 522 F.Supp. 1257 (S.D.N.Y. 1981).

Plaintiff Reprosystem B.V. was incorporated by plaintiff N. Norman Muller to hold the shares and assets he sought to purchase from SCM's foreign subsidiaries.

Defendant SCM is a multinational enterprise that manufactures and distributes a variety of products. In 1976 the part of its business that consisted of marketing, leasing, and servicing copy machines in Europe, Africa, and the Middle East, was conducted by SCM's International Business Equipment Division through six wholly owned subsidiaries incorporated under the laws of five foreign countries. During fiscal year 1976, the six subsidiaries together generated annual sales exceeding $40 million and profits exceeding $4 million, and had approximately one thousand employees.

In late 1975 Paul Elicker, who was president, chief executive officer, and chairman of the board of SCM, and Herbert Elgi, the vice president of finance, decided that SCM should dispose of its European copier subsidiaries. At Elicker's direction, Frank De Maio, who was vice president and general manager of the International Division, began to seek out potential purchasers.

Consistent with its decision to get out of the overseas copying business, SCM sought to minimize its commitment to any new products in that copier market. However, De Maio and William Rodich, the president of SCM's Business Equipment Division which included the International Division, recognized that SCM's zinc oxide paper process was outdated, and they concluded that regardless of ownership, the business would have to make available a plain paper copier. During the spring of 1976, therefore, De Maio traveled to Japan and reached a preliminary understanding with Mita, a Japanese manufacturer, to supply SCM with approximately 3,000 plain paper copiers.

Muller became interested in the proposed sale of the subsidiaries. He met in April 1976 with both Elicker and De Maio, and in May 1976 with Elicker and Rodich. During the May meeting Muller was provided with unaudited statements of the subsidiaries showing an asset value of approximately $16.8 million as of March 31, 1976, and a nine-month profit of approximately $3 million.

In a letter prepared without assistance of counsel Muller, on May 7, 1976, offered to pay $9 million for the SCM subsidiaries, subject to two conditions: (1) a satisfactory audit by Muller's accountants, and (2) execution of a formal agreement, satisfactory to both SCM and Muller. Rodich informed Muller that the letter provided a basis for negotiations, but that discussions would have to be suspended during a securities offering by SCM.

When negotiations resumed in August 1976, Rodich presented Muller with a list of nine points that SCM considered to be non-negotiable. These nine points, supplemented by four more in September, became the basis for an "agreement in principle" between Muller and SCM. One provision of the "agreement in principle" was that during negotiations the companies would be operated by SCM for the benefit of Muller, so that any profits or losses occuring after August 1, 1976 would be used to adjust the purchase price. SCM issued a press release on September 28, 1976 announcing the "agreement in principle", but stating also that "[t]he proposed sale is subject to a definitive agreement expected to be reached soon." SCM's 10-K report, filed with the SEC on September 30, 1976, also stated that SCM made "no assurance that the transaction would be completed."

The parties contemplated that the transaction would be developed in a "Global Agreement" setting out the general terms of the transaction, plus six separate agreements covering the respective details for the sales of the six subsidiary corporations. Using the "agreement in principle" as a starting point, general counsel for SCM prepared a draft model agreement for sale of one of the subsidiaries. After Muller's attorneys, Hardee, Barovick, Konecky & Braun, reviewed the draft and found it incomplete, SCM retained the firm of Sullivan & Cromwell to assist in negotiating and drafting all of the agreements.

Concentrating on the Global Agreement and a model agreement for one of the subsidiaries, Sullivan & Cromwell generated more than fifteen drafts by mid-December, each of which was reviewed by the Hardee, Barovick firm and returned for revision. Consistent with the proviso in Muller's initial offer that conditioned the contemplated transaction on execution of a formal agreement, each draft of the Global Agreement prepared by Sullivan & Cromwell provided that the obligations of each

party were subject to a condition precedent that it shall have been provided with an opinion from counsel for the other party that "this [Global] Agreement and each of the Purchase Agreements has been duly authorized, executed and delivered by [the other party]".

On December 15 and 16, 1976 the parties and their attorneys met to resolve all outstanding issues. At this meeting the drafts prepared by Sullivan & Cromwell were reviewed paragraph by paragraph, including the paragraphs that required formal execution as a prerequisite to binding effect. After two days of negotiations no problems remained, the parties exchanged congratulations, and Rodich took Muller to De Maio's office where he acknowledged that the meetings had been successfully completed.

On December 17, 1976 Rodich sent telexes to the general managers of the subsidiaries: "we now feel that the problems are resolved and that the deal is made subject to approval by various government agencies." On December 27, 1976 and January 5, 1977, "final drafts" of the Global Agreement and six separate agreements were circulated by Sullivan & Cromwell. Because Rodich was being reassigned to a new post, Elgi took over the negotiations on behalf of SCM. At year's end, Elgi reviewed the proposed transaction, discovered that the subsidiaries were operating more profitably than expected, and decided that the sale was a better deal for Muller than for SCM. Elgi proposed alternatives to Elicker in a meeting on January 4, including the alternative of killing the deal with Muller and selling the subsidiaries individually. Elicker instructed Elgi to attempt to close the proposed transaction with Muller.

In January the negotiations stalled. SCM introduced new items for negotiation, fired the New York management that was supposed to be transferred to Muller intact, and discovered an accounting error which led to a substantial increase in the purchase price. Muller con-

tinued to avoid SCM's requests that he document his ability to provide the purchase price on closing. On January 20, 1977 SCM issued a press release stating that it felt free to pursue other alternatives.

On January 31 Muller wrote SCM claiming that the "final drafts" constituted binding contracts for the purchase and sale of the subsidiaries. SCM responded on February 2 by terminating the negotiations. At no time was any of the draft contracts signed by either side.

II.

A. *Existence of a Contract*

Although "[c]ontract law has progressed and evolved sounder principles since the days of ritualistic and formalistic sealed instrument requirements", *V'Soske v. Barwick*, 404 F.2d 495, 499 (2d Cir. 1968), *cert. denied*, 394 U.S. 921, 89 S.Ct. 1197, 22 L.Ed.2d 454 (1969), there are still situations where the absence of a signed, formal agreement is fatal to an argument that a contract exists. This court summarized the alternative New York rules on this subject in *V'Soske*:

> First, if the parties intend not to be bound until they have executed a formal document embodying their agreement, they will not be bound until then; and second, the mere fact that the parties contemplate memorializing their agreement in a formal document does not prevent their informal agreement from taking effect prior to that event. * * * These rules, placing the emphasis on intention rather than form, are sensible and reasonable.

Id. at 499 (citations omitted).

In *V'Soske* we held that the party invoking the first rule of New York contract law described above must prove either that both parties understood they were not to be bound until the executed contract was delivered, or

that the other party should have known that the disclaiming party did not intend to be bound before the contract was signed. In *V'Soske* the defendant buyer failed to prove either proposition.

Thus, the primary question on this appeal is one of intent. *Banking & Trading Corp. v. Floete*, 257 F.2d 765 769 (2d Cir.1958). Did the parties intend not to be bound prior to execution of a formal contract? Or did they merely contemplate that their informal agreement would be reduced to a formal writing at some later time?

In this case the trial judge determined that the parties intended to be bound by the unexecuted "final drafts" and did not intend their contractual obligations to be contingent upon their signing formal contractual documents. He wrote:

> [I]t has been determined as a matter of fact that eventually both parties intended to be bound by the Final Drafts. Taking into account the totality of the parties' objective manifestations of intent as the transaction progressed and the circumstances surrounding the negotiations, I reject SCM's contention that a final signing would be required to constitute a binding agreement. In the circumstances at bar, SCM's—indeed, both parties'—contemplation of subsequent formal signed agreements did not overcome the objective facts which established an agreement.

Thus the district judge, relying upon the second rule of *V'Soske*, concluded that the parties merely contemplated memorializing their informal agreement in a signed, formal document. This finding of fact is subject to the clearly erroneous standards of review embodied in Federal Rule of Civil Procedure 52(a). *Banking & Trading Corp. v. Floete*, 257 F.2d at 769; *see also Oswald v. Allen*, 417 F.2d 43 (2d Cir. 1969) (meeting of minds is question of fact subject to Rule 52(a)). Therefore, the district court's finding that the parties intended to be con-

tractually bound prior to execution of the formal contracts must be upheld unless it was made without adequate evidentiary support, is against the clear weight of the evidence, or was induced by an erroneous view of the law. *See* 9 Wright & Miller, *Federal Practice and Procedure: Civil* § 2585 (1971).

Our review of the entire record leaves us with the definite and firm conviction that a mistake was made by the district court, *United States v. United States Gypsum*, 333 U.S. 364, 395, 68 S.Ct. 525, 542, 92 L.Ed. 746 (1948), because the documents and testimony clearly showed that the intent of both parties was not to be bound prior to the execution of a formal, written contract. Therefore, the first rule summarized in *V'Soske* applies, and SCM was not bound by the "agreement in principle", by the "final drafts", or by any claimed oral understanding reached in the course of the extended negotiations.

The uncontested evidence clearly establishes the parties' intent not to be bound prior to execution of formal contracts. Muller's initial purchase offer was made on the expressed condition that "a formal agreement, which is satisfactory to SCM and [plaintiffs] be entered into." Muller testified that Rodich "had no problem with that." Additionally, the September press release, prepared by SCM and reviewed by Muller, stated: "The proposed sale of the European copier business is subject to a definitive agreement expected to be reached soon." SCM's 10-K report, filed with the SEC in September 1976, also stated: "[SCM] makes no assurance that this transaction will be completed."

Finally, the numerous drafts of the "Global Agreement" conditioned the parties' obligations on the receipt of opinions from counsel of both buyer and seller confirming that the "[Global] Agreement and each of the Purchase Agreements have been duly authorized, executed and delivered". Draft agreements for the sale of several

of the subsidiaries had similar provisions. Additionally, the drafts of the Global Agreement provided "when executed and delivered, this [Global] Agreement and each of the Purchase Agreements will be a valid and binding agreement * * * in accordance with its terms." Despite their many other differences over the proposed contracts, neither party took exception to these provisions that conditioned their binding effect on formal execution and delivery. Thus, the contract drafts, combined with the parties' other written communications, conclusively establish a mutual intent not to be bound prior to execution of the formal documents, and the district court's finding to the contrary is clearly erroneous. Its conclusion that a contract existed must, therefore, be reversed.

The result we reach is supported by prior decisions applying New York law. In *Banking & Trading Corp. v. Floete*, 257 F.2d 765, we affirmed the district court's holding that no contract existed because defendants had circulated to dealers in the trade a letter which required executed contracts, and that the letter was sufficient to communicate the defendant's intent not to be bound. Similarly, in *ABC Trading Co. v. Westinghouse Electric Supply Co.*, 382 F.Supp. 600 (E.D.N.Y. 1974), the district court held that a single reference to a written contract in a letter from defendant to plaintiff was sufficient to put plaintiff on notice and to prevent the defendant from being obligated until a formal agreement was signed. *See also Chromalloy American Corp. v. Universal Housing Systems*, 495 F.Supp. 544 (S.D.N.Y. 1980), *aff'd mem.*, 697 F.2d 289 (2d Cir. 1982) (offer to purchase conditioned on execution of written contract held sufficient to show intent not to be bound prior to signing); *Scheck v. Francis*, 26 N.Y.2d 466, 311 N.Y.S.2d 841, 260 N.E.2d 493 (1970) (transmittal letter showed intent not to be bound until contract signed). *Cf. Disken v. Herter*, 73 A.D. 453, 77 N.Y.S. 300 (App. Div. 1902), *aff'd*, 175 N.Y. 480, 67 N.E. 1081 (1903) (where parties did not express their intent to defer binding effect until execution of for-

mal document, oral contract held valid); *Municipal Consultants & Publishers, Inc. v. Town of Ramapo*, 47 N.Y. 2d 144, 417 N.Y.S.2d 218, 390 N.E.2d 1143 (1979) (same).

Of equal importance, the result we reach is consistent with the realities of the complex transaction at issue. The proposed deal involved a $4 million sale of six companies which were incorporated under the laws of five different countries and which had assets of over $17 million, sales of $40 million, and profits of $4 million. Completing the transaction would require approvals of foreign governments, sales of both securities and assets, and the transfer of almost one thousand foreign employees, not to mention the myriad additional details attendant upon the sale of any business. Thus, the magnitude and complexity of the deal as reflected in the numerous written contract drafts not only reinforce the parties' stated intent not to be bound until written contracts were signed, but also reflect a practical business need to record all the parties' commitments in definitive documents. *See Banking & Trading Corp v. Floete*, 257 F.2d at 769; *International Telemeter Corp. v. Teleprompter Corp.*, 592 F.2d 49, 57-58 (2d Cir. 1979) (Friendly, *J.*, concurring) (describing realities of modern corporate "deals"). Since the parties intended not to be bound prior to execution of those written documents and since none was ever executed, no contract came into existence.

Our conclusion that no contract existed eliminates the only basis on which Judge Sweet awarded damages to plaintiffs. Nevertheless, the plaintiffs argue on this appeal that the award can be sustained on alternative theories of unjust enrichment and breach of a duty to negotiate in good faith. We disagree.

B. *Unjust Enrichment*

After concluding that a binding contract existed between SCM and Reprosystem, the district court addressed

the question of damages, holding that because plaintiffs would not have been able to perform they were not entitled to traditional contract damages. Rather than send the plaintiffs away emptyhanded, however, the trial court awarded breach-of-contract damages measured by principles of unjust enrichment. Citing the *Restatement (Second) of Contracts* and *Corbin*, the court stated, "The remedy of restitution to prevent unjust enrichment is commonly applied both in the realm of quasi-contract and as an alternative basis for recovery upon breach of contract." The trial court held that SCM was obligated by its agreement to sell the subsidiaries to plaintiffs and that to allow SCM to breach the contract and keep all the profits from its subsequent sale of the subsidiaries to others would "condone unjust enrichment." He therefore looked to the provision in the "agreement in principle" that obligated SCM during the negotiation period to operate the subsidiaries for Muller's benefit, and he awarded to plaintiffs the $1 million in profits earned by the subsidiaries between August 1, 1976 and February 2, 1977. Thus, the basis for Judge Sweet's award of damages was SCM's breach of the alleged contract; unjust enrichment merely provided the measure of those damages. However, our reversal of the trial court's conclusion that a contract was created removes the predicate for plaintiffs' recovery for breach of contract. We have also considered plaintiffs' claim to a recovery grounded independently in the equitable doctrine of unjust enrichment, but we find that claim to be without merit in the circumstances of this case.

The equitable doctrine of unjust enrichment rests, generally, on the principle that a party should not be allowed to enrich himself at the expense of another. *Miller v. Schloss*, 218 N.Y. 400, 113 N.E. 337 (1916). Under New York law, a plaintiff seeking an equitable recovery based on unjust enrichment must first show that a benefit was conferred upon the defendant, and then show that

as between the two parties enrichment of the defendant was unjust. *See Indyk v. Habib Bank Ltd.*, 694 F.2d 54, 57 (2d Cir. 1982).

Plaintiffs argue that Muller conferred benefits on SCM by making several contributions to preserve SCM's subsidiaries and by causing dramatic improvement in their operations and profits. These benefits, Muller claims, resulted from several trips to Europe, reviewing of financial reports, securing suppliers, arranging financing from banks, introducing key man insurance, and participating in continuing operations. The most important contribution claimed by Muller was his development of the plain paper copier program with Mita, which plaintiffs claim resulted in enormous profits to SCM, profits that would have been plaintiffs' if SCM had not killed the deal.

The record shows, however, that Muller's activities had little to do with the subsidiaries' successful operation during the negotiation period. Muller did take several trips to Europe in the fall of 1976, during which he discussed the subsidiaries' future with SCM foreign management and consulted with several prospective lenders and suppliers. However, there is no evidence to show that Muller actually obtained credit for ongoing financing with banks or that he secured any suppliers other than those who were already dealing with SCM.

Equally unsupported is plaintiffs' claim that Muller contributed to the subsidiaries' success by developing the Mita plain paper copier project. As defendants argue, and as the district judge recognized, SCM at all times had a vested interest in preserving the good will of its subsidiaries and was aware that any prospective purchaser would require plain paper copiers. Thus, while SCM obviously sought to minimize its commitment to this new product line, it nevertheless made preliminary arrangements to obtain a supply of these copiers from Mita in the spring of 1976, several months before negotiations

with Muller reached a serious stage. Similarly, SCM—not Muller—ordered and tested the Mita prototypes that were displayed at the October 1976 trade fair. The district judge found that it was this display, reflecting SCM's commitment to the conversion to plain paper copiers, that helped preserve the subsidiaries' sales force.

In contrast to SCM's role, Muller's involvement with the Mita project was limited to a single "letter of intent" sent to Mita in December 1976 by De Maio, who was still an employee of SCM, indicating that Reprosystem intended to purchase 3,000 plain paper copiers. This sole event, occurring near the end of the relevant time period, provides insufficient support for plaintiffs' argument that Muller's efforts with respect to the Mita project held the subsidiaries together and conferred a million dollar benefit on SCM.

We conclude that plaintiffs failed to show that they bestowed any benefit upon SCM; therefore, plaintiffs' award cannot be based on unjust enrichment. Moreover, even if we were to conclude that plaintiffs had conferred some benefit on SCM, plaintiffs have not shown that there is anything unjust about SCM's retaining the profits from SCM's businesses run by SCM's management at SCM's expense.

C. *Duty to Negotiate in Good Faith*

Plaintiffs also seek to justify their recovery below by claiming that SCM breached an obligation to negotiate in good faith. The district court apparently found that such a duty was created by the alleged contract between the parties, for it stated: "On the facts as I have found them, I concluded not only that SCM breached the agreements reached at the end of 1976, but that it specifically breached its duty of good faith negotiation and performance required by those agreements." However, our conclusion that no contract existed eliminates this as a possible basis for imposing such a duty on SCM.

As the district court recognized, under some circumstances a party to a contract may be bound by an implied agreement to negotiate in good faith to reach an agreement. *See Pepsico Co., Inc., v. W.R. Grace & Co.*, 307 F.Supp. 713, 720 (S.D.N.Y. 1969). In this case such an agreement might be inferred from the "agreement in principle." *Compare Thompson v. Liquichimica of America, Inc.*, 481 F.Supp. 365 (S.D.N.Y. 1979). Nevertheless, whatever implied agreement that existed here was too indefinite to be enforceable under New York law. *See Joseph Martin, Jr., Delicatessen, Inc.* v. *Schumaker*, 52 N.Y.2d 105, 436 N.Y.S.2d 247, 417 N.E.2d 541 (1981); *Candid Productions Inc. v. International Skating Union*, 530 F.Supp. 1330 (S.D.N.Y. 1982). Consequently, plaintiffs cannot succeed on the theory that they are entitled to damages because defendants breached a "duty to negotiate in good faith."

D. *Promissory Estoppel*

On their cross-appeal, plaintiffs ask us to reverse the district court's conclusion that they failed to establish promissory estoppel as an alternative basis for recovery. In New York the elements of a claim for promissory estoppel are: "a clear and unambiguous promise; a reasonable and foreseeable reliance by the party to whom the promise is made; and an injury sustained by the party asserting the estoppel by reason of his reliance." *Ripple's of Clearview, Inc. v. LeHavre Associates*, 88 A.D. 2d 120, 452 N.Y.S.2d 447, 449 (N.Y.App.Div. 1982) (citations omitted).

In our view the district court correctly ruled that plaintiffs failed to establish a promissory estoppel here. Plaintiffs can neither point to any clear and unambiguous promise made by SCM to the effect that it would consummate the deal, nor show that they reasonably relied on any promise implied from SCM's conduct during the negotiations. The negotiations of the parties as reflected

in the draft agreements made it clear that the obligations of both SCM and Muller were contingent upon execution and delivery of the formal contract documents. *See Brause v. Goldman*, 10 A.D.2d 328, 199 N.Y.S.2d 606 (N.Y.App.Div. 1960) *aff'd*, 9 N.Y.2d 620, 210 N.Y.S.2d 225, 172 N.E.2d 78 (1961).

E. *Securities Fraud*

Finally, plaintiffs urge us to reinstate their claim for violations of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1983), promulgated thereunder. True, the district court dismissed the securities fraud count by erroneously relying on the "sale of business" doctrine, which although adopted in other circuits, *see Frederiksen v. Poloway*, 637 F.2d 1147 (7th Cir.), *cert. denied*, 451 U.S. 1017, 101 S.Ct. 3006, 69 L.Ed.2d 389 (1981); *Chandler v. Kew, Inc.*, 691 F.2d 443 (10th Cir. 1977); *King v. Winkler*, 673 F.2d 342 (11th Cir. 1982), has been rejected in this circuit, *Golden v. Garafalo*, 678 F.2d 1139 (2d Cir. 1982); *see also Seagrave Corp. v. Vista Resources, Inc.*, 696 F.2d 227 (2d Cir. 1982); *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202 (4th Cir.) *cert. denied*, 444 U.S. 868, 100 S.Ct. 142, 62 L.Ed.2d 92 (1979); *Daily v. Morgan*, 701 F.2d 496 (5th Cir. 1983). Nevertheless, plaintiffs cannot recover for securities fraud, because they do not satisfy the "purchase or sale" requirement of *Birnbaum v. Newport Steel*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed. 1356 (1952).

Plaintiffs were not and do not claim to be actual purchasers or sellers of SCM stock. They claim only that their right to sue under Rule 10b-5 arises from the alleged contract to sell the shares of the subsidiaries, and they rely on those cases in this circuit that have held that a plaintiff can sue for fraud connected with an oral contract for the sale of securities. *See Desser v. Ashton*,

408 F.Supp. 1174 (S.D.N.Y. 1975), *aff'd mem.*, 573 F.2d 1289 (2d Cir. 1977); *Commerce Reporting Co. v. Puretec, Inc.*, 290 F.Supp. 715 (S.D.N.Y. 1968).

However, because we have concluded that SCM did not enter into a contract, the plaintiffs fall outside even that enlarged class of persons who are protected by Rule 10b-5. Judge Sweet's dismissal of plaintiffs' securities fraud action is therefore affirmed.

III.

We conclude that the district court clearly erred in finding that a contract existed between the parties, that SCM was unjustly enriched, and that SCM owed a duty to negotiate in good faith with Muller and Reprosystem. Plaintiffs have not demonstrated any other basis for liability on the facts found below. Accordingly, the judgment of the district court is reversed on the contract claim, and affirmed insofar as it dismissed plaintiffs' remaining claims.

APPENDIX B

UNITED STATES DISTRICT COURT
S. D. NEW YORK

No. 77 Civ. 5705 (RWS)

REPROSYSTEM, B. V., and N. NORMAN MULLER,
Plaintiffs,

v.

SCM CORPORATION,
Defendant.

June 30, 1981

OPINION

SWEET, District Judge.

This action was filed by plaintiffs Reprosystem, B. V. ("Reprosystem") a Netherlands corporation, and N. Norman Muller ("Muller"), a New York resident, against the defendant SCM Corporation ("SCM"), a New York corporation. The complaint alleged damages for breach of contract, promissory estoppel, failure to perform and to negotiate in good faith, unjust enrichment, and fraud under the federal securities law and the common law. After extensive discovery, a four week trial before the court was held in the course of which 17 witnesses testified and well over 1,000 documents were introduced into evidence. At issue are the rights and liabilities of the parties arising from an unsuccessful effort in 1976 by Muller and Reprosystem to purchase the European photocopier business of SCM. Both sides were represented by extremely able counsel, not only during the events giving rise to the litigation but particularly during its trial. The issues presented, both factual and legal, constitute an almost exhaustive pathology of an important corporate transaction. For reasons more fully set forth

below, Reprosystem and Muller are entitled to recover certain of their damages resulting from SCM's breach of contract and failure to bargain in good faith.

FINDINGS OF FACT

The Parties

SCM is a multinational conglomerate manufacturing and distributing a number of industrial, commercial and consumer products. Its shares are listed on the New York Stock Exchange. Prior to 1975 and during 1976 and the first half of 1977 it engaged in the business of marketing, leasing and servicing office copiers, paper and toner throughout Western Europe, the Middle East and Africa. This business was conducted by its International Business Equipment Division through six wholly owned subsidiaries: Smith-Corona Marchant, S.A., a French corporation; SCM International S.A., a Belgian corporation; SCM (Switzerland) S.A., a Swiss corporation; SCM (Deutschland) GmbH, a German corporation; Smith-Corona Marchant International S.A., a Swiss (Chur) corporation; and SCM (United Kingdom) Ltd., a United Kingdom corporation. (These six subsidiaries are collectively referred to as the "copier subsidiaries" or "subsidiaries.") During the 1976 fiscal year (ending June 30, 1976) the copier subsidiaries had assets of about $17,000,000, total sales exceeding $40,000,000, operating profits exceeding $4,000,000, and approximately 1000 employees.

Reprosystem was organized in the fall of 1976 to hold the shares and assets of the subsidiaries. Its shares were owned by Reprographex Antilles, N.V., a Dutch Antilles corporation which in turn is a wholly owned subsidiary of Reprographex International, Inc., a Delaware subsidiary of MacMuller Industries, Inc., another Delaware corporation. At the time of the transaction, a majority interest of Reprographex International, Inc. was owned by Muller individually. Muller also owned a controlling interest in MacMuller Industries, Inc., which

during most of the period in question owned and operated Eagle Shirts, Inc. and Petrocelli Clothes, Inc. Muller was responsible not only for his own conduct as an individual but for that of the corporations which he controlled. He was an experienced businessman with "ability to raise cash."

The Preliminaries

Late in 1975 at a corporate planning meeting in Bermuda, Paul Elicker, the President and Chief Executive and Chairman of the Board of SCM ("Elicker") and Herbert Egli, the Vice President—Finance and Controller of SCM, ("Egli") and presumably others concluded it was in SCM's best interest to divest itself of its European copier business. This decision was communicated to Frank DeMaio, Vice President and General Manager of the International Group ("DeMaio").

The business of the subsidiaries consisted principally of the distribution of zinc oxide coated paper photocopiers, generally through lease of copier equipment, and sometimes through sale. Under the lease method, the subsidiaries would lease and service equipment, and this equipment was identified as Equipment Held for Lease. The subsidiaries also marketed paper supplies and toner to equipment users, and serviced the equipment. Between 1972 and 1974 annual operating profits of the copier subsidiaries ranged from about $4 million to about $5 million. DeMaio and Elicker sought out potential purchasers of this business, principally among its suppliers, without success. Through DeMaio a firm specializing in bringing together those interested in buying and selling corporate interests learned of the SCM purpose and advised Muller, who met first with DeMaio and then with Elicker and DeMaio in April, 1976. At the outset Muller and DeMaio had an understanding that if the proposed sale was accomplished DeMaio would receive an equity interest in the acquiring company. In May a meeting was attended

by Muller, Elicker and William Rodich ("Rodich"), President of the Business Equipment Division of SCM of which the International Group and the copier subsidiaries were a part. The business of the subsidiaries was described. Muller was provided with a statement of the asset value of the subsidiaries as of March 31, 1976, showing an aggregate book value of $16.8 million on an unaudited basis. The current profit and loss statement, also provided to Muller, showed a nine month profit of about $3.0 million.

A subsequent review by SCM's accounting department indicated that this unaudited statement might have been overstated by $1 million. However, there is no evidence that, if the asset value was indeed overstated, the overstatement was deliberate and for a fraudulent purpose. The full disclosure offered to Muller and his accountants by SCM in the fall of 1976 also serves to refute any fraudulent purposes. A projected drop in operating profits in fiscal 1976-1977 for the subsidiaries of less than $600,000 was not disclosed.

Although not expressed in writing initially, both parties had certain underlying concerns. SCM desired to divest itself of the business, to protect against any further liabilities either on bank or employee severance guarantees, and to protect its good will and relationships with customers and suppliers since it intended to remain in the typewriter business. Muller sought to purchase an ongoing business and its distribution network with its capacity to introduce new items. Early in the discussions it was recognized that the availability of a plain paper copier as opposed to a zinc oxide coated paper copier was an important, if not vital, aspect of the business. SCM, having decided to get out of the copying business, sought to minimize its commitment to this new product, while Muller believed a plain paper copier essential to the continuation of the business. Rodich and DeMaio had concluded that the availability of plain paper

copiers was necessary, regardless of the ownership of the business, and during the spring of 1976 DeMaio travelled to Japan and reached a preliminary understanding with Mita, a Japanese manufacturer, to provide plain paper copiers for SCM's benefit. These underlying concerns of the parties were articulated and understood but not made the subject of any writing at this early state.

By letter of May 7, 1976, Muller offered to pay $9.0 million for the subsidiaries. His letter also contained the following language, which forms a keynote to SCM's position on the law:

> This offer is made subject to the following conditions:
>
> 1. that a satisfactory audit review will be performed by our accountinng firm, S. D. Leidesdorf & Co.
>
> 2. that a formal agreement, which is satisfactory to SCM and ourselves be entered into.

Rodich informed Muller that his May 7 letter provided the basis for negotiation, but all further discussions were deferred because of a security offering by SCM and a consequent "quiet period." However, on August 4 discussions were resumed at a luncheon at the Atrium Club attended by Rodich, Egli, Muller and Brier, the latter being a participant in MacMuller Industries, as well as officers of Citibank where Muller and his companies banked. One of the purposes of the meeting was to discuss Muller's financial standing. Wallace of Citibank stated his satisfaction with the bank's relationship with Muller and added that he dealt only with seven figure accounts. No further representations were made or requested. Muller at the time was seeking financing from Citibank, financing which he failed to obtain. Shortly thereafter SCM obtained a Bishop Service and a Dun & Bradstreet report relating to Muller. Muller's strengths were described in the Bishop Service report by

one source as "putting together financial deals, acquisitions and raising money." No further questions were raised concerning Muller's finances during this phase of the discussions.

The Agreement in Principle

Shortly after the Atrium meeting Rodich gave Muller a list of items which he considered to be essential to SCM in connection with the contemplated transaction. At a later meeting in September this list was supplemented by four additional items. These memoranda are annexed as an Appendix to this decision. These points were viewed as "the Bible" by Rodich according to Muller and were non-negotiable. Whether or not the term was in fact used, these documents constituted the basic agreement which remained in place throughout the discussions, including the formula by which the purchase price was to be calculated. Muller accepted these items, the firm of Hardee, Barovick, Konecky & Braun ("Hardee Barovick") was retained by Muller, meetings were held and at one point in August it was even suggested that consideration be given to a closing at the end of the month, an objective which continued to elude the parties.

In mid-September, principally as a consequence of Rodich's memoranda it had been agreed by Rodich and Muller that Muller would purchase the non-typewriter European business of SCM, that the purchase price would be calculated on the basis of a formula derived from Muller's offer of \$9.0 million cash for \$16.4 million assets as of August 31, 1976, that the typewriter assets would be stripped out by SCM prior to closing, that the business would be operated by SCM for Muller in its ordinary course after August 31, 1976 and that the purchase price would be adjusted to reflect events subsequent to that date. The transfer would be in a form determined by SCM, which initially called for the intended transfer of the stock of the French, German, Bel-

gian and Swiss subsidiaries, and the transfer of the copier assets of the U.K. and Chur subsidiaries. SCM retained its claims against Xerox Corporation for damages in a pending litigation involving, among other things, claims that Xerox unfairly competed with the SCM copier subsidiaries. Muller assumed responsibility for possible employee severance and vacation pay obligations, leases and employees in the U.K. relating to the copier business, and the performance of SCM purchase agreements for equipment and supplies. Muller had the right to license and use the SCM name and logo for three years with appropriate safeguards on its use. SCM made certain warranties with respect to undisclosed liabilities, inventories and accounts receivable. Discussions on these matters correlated the "deep discount" from stated asset value with the assumption by Muller of the employee severance liability and lease obligations of SCM.

The burden of preparation of more formal documents fell upon Arthur J. Mannion, Jr. ("Mannion"), inside counsel for SCM, his work product then to be reviewed by the Hardee Barovick firm. The latter firm also employed Harvey Dale as outside tax consultant. A closing at the end of September was then anticipated. Both sides dispatched teams of lawyers and accountants to Europe, the latter to conduct "a businessman's review" and the former to obtain facts and delineate issues to be incorporated in the agreements to be signed. The parties resumed discussions in New York in the latter part of September dealing in part with issues resulting from the trip, including the effect of a French transfer tax and the anticipated time to obtain a necessary Bank of England approval.

In connection with its 10-K report for the fiscal year ending June 30, and other matters, Eliker met with the SCM board and after discussion the following resolution was adopted:

> We have agreed in principle to sell our European office copier operations to N. Norman Muller, a private investor who owns substantial interests in various businesses. Current personnel and management will continue to operate the sold business.

SCM's 10-K filed with the SEC on September 30, 1976, stated in relevant part:

> In late September, 1976, the Company reached an agreement in principle to sell its European copier sales and service operations. These operations account for approximately 40 percent of SCM's copier products net sales, with an operating income of approximately $2 million in fiscal 1976 which was expected to decline in fiscal 1977. The Company makes no assurance that this transaction will be completed.

During the same period Muller was anxious to make his presence felt in Europe and to establish a relationship with the general managers of the subsidiaries. A trade exhibition in Paris in late September 1976, the SICOB show, provided an opportunity to satisfy Muller's needs. That, together with SCM's reporting requirements, resulted in a press release which was issued on September 28, 1976, and which stated with respect to the transaction:

> SCM Corporation has reached an agreement in principle to sell its office copier service organizations in the United Kingdom, France, Germany, Switzerland and Belgium and its distribution operations covering Europe, the Middle East and Africa to a company controlled by N. Norman Muller, a private investor.
>
> While terms of the agreement in principle were not disclosed, Paul H. Elicker, president of SCM, indicated that SCM would incur a pre-tax loss of approximately $1.4 million on the transaction.
>
> . . . . .
>
> The proposed sale of the European copier business is subject to a definitive agreement expected to be

reached soon. SCM said that all parts of the combined 900-man marketing operation would be sold to the new owners intact and the current management will continue to operate the business. . . .

The announcement was reported in The New York Times, The Wall Street Journal, on the Dow Jones ticker tape and elsewhere. These events aroused sufficient interest in Muller to result in an article in *Forbes* which reported that Muller intended to use his own assets to buy the subsidiaries, a report that was more fictional than factual, given Muller's discussion with Citibank and his later discussions with the Chemical Bank to be considered below.

The "agreement in principle" thus approved by the SCM Board and announced to the public at large consisted largely of the thirteen items set forth in Rodich's August and September memoranda, to which Muller had agreed. These points with some additions and alterations remained central to the negotiations throughout.[1]

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[1] Plaintiffs' version of the Agreement in Principle accords with the evidence. The thirteen points are integrated and summarized as follows:

(1) SCM was to sell and transfer all the six copier subsidiaries, except for business operations relating to typewriters.

(2) The typewriter assets were not to be transferred, but were to be retained by SCM.

(3) SCM was to retain all cash and cash equivalents of the copier business as of August 31.

(4) The transfer would be in a form determined by SCM; SCM determined, based on its tax interests, to transfer the stock of the French, German, Belgium and Swiss subsidiaries, and to transfer the copier assets of the U.K. and Chur subsidiaries.

(5) The purchaser would be a company to be formed by Mr. Muller.

(6) The purchase price was to be the dollar equivalent of 53.4% of the book value of the copier assets of the companies

After the issuance of the September 28 press release, the principals left for Paris where the SICOB show was in progress. Rodich addressed a luncheon meeting of the

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as of August 31, 1976, to be calculated after asset values were determined as of this date.

(a) As noted above plaintiffs assumed the balance sheet liabilities towards payment of the purchase price and, if any balance remained, this was to be paid in cash.

(b) SCM would have the right to allocate the total purchase price among the six subsidiaries and assign values to each of the four stock sales and two asset sales.

(7) SCM would retain claims it had against Xerox Corporation for damages in a pending litigation involving, among other things, claims that Xerox unfairly competed with the SCM copier subsidiaries.

(8) The purchaser would assume responsibility for:

(a) possible employee severance and also vacation pay obligations;

(b) in the U.K., leases relating to the copier business and employees relating to the copier business; and

(c) performance under purchase agreements of SCM for equipment and supplies.

(9) Plaintiffs would have the right to license and use the SCM name and logo for three years with appropriate safeguards on its use.

(10) As to possible undisclosed liabilities, shortages of inventory, and uncollectible receivables, SCM undertook as follows:

(a) It warranted against undisclosed liabilities for all claims over $10,000, and, if they were under $10,000 per claim, to the extent such claims in total exceeded $150,000.

(b) It would be responsible for shortages of inventory count to the extent they in total exceeded the inventory reserve.

(c) SCM would be responsible for uncollectible receivables to the extent they in total exceeded the receivable reserve plus $200,000 (but in no event less than $500,000) and to the extent of 53% for each dollar thus in excess.

The additional agreed-upon terms relating to transfer of the subsidiaries are accurately summarized by the plaintiffs as follows:

general managers of the subsidiaries at the Hotel Crillon, sought their cooperation during the period before the contemplated transfer could take place, offered a substantial bonus in the event that the transaction was completed as contemplated, and introduced Muller as the intended buyer. He then left the meeting and returned to New York. Muller remained and discussed the business of the subsidiaries with the general managers, and attended the SICOB show and a reception given at the Hotel Intercontinental for the general managers and suppliers to the subsidiaries. These events ended up as charges to Muller's bill at the Crillon, as did the charges for the living expenses of Muller's party, all of which were subsequently paid for by the French subsidairy. SCM seeks repayment of approximately $14,000 by way of counterclaims, more to establish some of the color surrounding these events than to be made whole financially, and of course Muller is responsible for any expenses not related to his business activities. The evidence presented, however, has been inconclusive as to the amount properly attributable to Muller's personal expense.

The Drafting Period

After returning to New York a first draft on an agreement on the sale of one of the subsidiaries was prepared by Mannion. It was considered to be incomplete by the Hardee Barovick firm, some words were had on the sub-

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(1) The operations of the subsidiaries and any profit or loss after August 31, 1976 in the operations of the businesses would be for the plaintiffs' account and benefit.

(2) The businesses being sold would be operated "in the ordinary course of business" from August 31, 1976 until the closing, preserving, among other things, the companies' goodwill with general managers, suppliers and customers.

(3) The businesses would be transferred "intact" and as an "ongoing operation" and as part of this, all New York management personnel and all general managers would be transferred.

(4) Mr. DeMaio would be in charge of operations until closing.

ject, and by early November SCM retained Messrs. Sullivan & Cromwell to assist in the negotiations and preparation of agreements.

On November 8, 1976, SCM's Board of Directors adopted the following resolution:

> RESOLVED, that the officers of the Company be and hereby are authorized to negotiate the sale of the Business Equipment Division copier operations in England, France, Germany, Belgium (including distributor operations) and Switzerland to N. Norman Muller or a company(ies) owned by N. Norman Muller at such prices and pursuant to such other terms and conditions, as in its absolute discretion, may be approved by the Executive Committee of the Board of Directors. . . .

It is undisputed that both parties anticipated that a final written agreement would be reached and executed, an anticipation that, of course, was never fulfilled although a closing date of March 31, 1977 was acceptable to Rodich and was subsequently advanced at SCM's request as more fully set forth below. Meetings were held between counsel on November 16, 17, 18 and December 10 and with the participation of the respective clients on December 15 and 16. Drafts were discussed and negotiated. The starting points for these discussions were the thirteen points outlined by Rodich in August and September and accepted by Muller before the SICOB trip. The negotiations produced a number of refinements and changes.

The non-copier assets of the French, German, Swiss and Belgian subsidiaries, the shares of which were to be acquired by Muller, were not to be stripped out prior to closing but rather to be transferred to third parties, affiliates of SCM, for cash. Since the transaction contemplated a purchase price based on the formula described above, this change increased the cash in the subsidiaries at the time of closing and thus increased the cash required to close.

Throughout it was understood that SCM was concerned about its employee severance liability and its good will. Clauses were drafted to prevent dividends, loans and pledges which would transfer funds from the Muller operating companies to Muller or his holding companies.[2] These clauses were designed to prevent Muller from removing assets from the subsidiaries but did not by their terms prevent any other transfer pledges or loans to third parties.

SCM sought to obtain a personal guarantee from Muller and a commitment to operate the subsidiaries for three years. The request was refused, and no provision appeared in the last drafts on this subject. SCM sought a provision requiring approval by its Board of Directors before signing, a request which was rejected in view of the action already taken and upon the view of SCM's counsel that the signature would not be affixed unless the agreement was approved.

At the negotiations at the Atrium Club in August, SCM had sought reassurance as to Muller's financial competence. The Dun & Bradstreet and Bishop's reports had been reviewed. During the negotiations in the fall SCM sought Muller's personal guarantee and certified financials but these requests were rejected by Muller. The issue was resolved by the limitation on upstream pledges, loans and dividends, the purpose of which was to prevent the transfer of funds to Muller which might jeopardize the viability of the subsidiaries.

During this period from September through December it was understood by all concerned that the companies which were to be the subject of the agreement were being operated by SCM for the benefit of Muller. So-

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[2] These clauses in the last drafts permitted upstream transfers "so long as the funds came to rest within the pool." In other words, for tax or accounting purposes the funds could be transferred simultaneously as long as they remained available for use in the pool.

called "Flash Reports," weekly forms reporting the pertinent financial data, were shared with Muller. Rodich had instructed DeMaio to keep Muller apprised of all developments. No significant problems were raised or discussed between the parties during the period concerning the operation of the business in the normal course. However, one significant development, relating to the production and marketing of a plain paper copier, began to cast a shadow over the business picture.

DeMaio, after being instructed in the fall of 1975 that SCM intended to cast his division adrift, loyally assisted in the plans to locate a willing buyer to whom the business could be transferred. However, he was persuaded that the viability of the business even to its new owners required the capacity to compete in the plain paper copier field whether or not SCM had determined to abandon this field. To this end he had obtained Rodich's agreement to travel to Japan in the spring of 1976 to select a manufacturer of a plain paper copier and arrange for its production as recounted above. By early fall he had exchanged correspondence with Mita relating to the production of a plain paper copier, its testing and the purchase of a number of copiers. Muller shared DeMaio's belief that the availability of a plain paper copier was essential to the health of the European subsidiaries. The SICOB show was the public debut of the Mita plain paper copier, and the European managers were encouraged and enthusiastic, shared DeMaio's hope for the success of this product and the consequent commissions on sales, a factor which served to hold the sales organizations together during this period of uncertainty. Orders for sales were taken for production to commence some time around the first of the year, and these orders appeared on the Flash Reports.[3]

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[3] The orders for the plain paper copiers from late September through January, as indicated by the Flash Reports, were approximately 450.

It was anticipated that the Mita copier would cost in the neighborhood of $3,000 and be sold for approximately $4,000 and that approximately 2,000 units would be involved in the first year's production. Thus an initial investment of $6 million was in contemplation. Since SCM in its 1976-77 budget had determined to reduce its commitment to the copier business and to liquidate its investment, and since Muller felt that plain paper copiers essential to his ability to carry on the business, the production of the plain paper copier had the potential of presenting a significant divergence in business objective between Muller and SCM. However, only the tip of this issue could be perceived on the horizon in mid-December, and neither of the parties focused upon it. By all that had been discussed between the parties and their counsel, the operation of the business was proceeding to the satisfaction of each.

The Agreement and Final Events of 1976

By mid-December counsel had produced 16 drafts, and pressures were building up for a resolution. Rodich was to be reassigned as of January 1, 1977 to become President of the Chemical and Metallurgical Division of SCM headquartered in Baltimore, and as the principal negotiator for SCM he sought to conclude the discussions. He called a meeting at SCM for December 15 to be attended by all counsel and their clients with the purpose of clearing up all matters then outstanding.

Rodich, Muller, and DeMaio, Robert Kay, and Ronald Konecky, counsel for the buyer, John Merow and Charles Sprague, counsel for the seller, James Conway, the chief auditor of SCM and Ben Evans, the S. D. Leidesdorf partner bearing accounting responsibility for Muller, and two other lawyers all testified as to the conduct of this meeting. Two drafts were discussed, one a "Global" Agreement between buyer and seller and the second, the agreement for the sale of the French company which was intended not only to serve to govern that transfer but

also to serve as a prototype of the agreements to be completed with respect to the Belgian, Swiss and German companies. It is undisputed that the drafts were reviewed, page by page, and all open issues were sought to be resolved. Parties caucused in various groups, discussions were held, and agreement was reached wherever possible. It was contemplated that another draft would be generated by Sullivan & Cromwell, and indeed on the evening of December 15 another draft of the Global Agreement was produced.

The meeting continued on December 16, and at its conclusion the assembled group was asked by Rodich whether there were any open terms, and none were advanced. Sullivan & Cromwell was to provide agreements embodying the discussions. The negotiators were released, and adieus, season's greetings and congratulations were exchanged. Rodich escorted Muller to DeMaio's office, and advised the latter that the meetings had been successfully completed. Whether or not Rodich stated, as recalled by Muller and DeMaio, "Frank, shake hands with your new boss, the deal is done," the import of the meeting with DeMaio was to acknowledge in an informal manner the transfer of power. In addition Rodich took Muller to Egli's office and advised Muller that Egli would finish up the transaction. He also informed the finder that his fee could be expected around Christmas or shortly thereafter.

On December 16, the Board of SCM met and the following minute was made with respect to Elicker's report:

> He commented on the sale of the European copier business and the assignment of domestic copiers to Allied Paper.

By deposition Elicker expanded on this subject, stating that he had informed the Board that he remained hopeful, that the negotiations were "stuck," that Rodich's transfer would be completed and that Egli would take over for the short and temporary period remaining.

Elicker also testified by deposition that a receivable for the Muller transaction had been booked by the Board in 1976. Both Egli and Conway disputed this fact, and testified that no such entry appears on the SCM books. Egli also indicated that Elicker must have confused the September write-down of the copier assets when he testified about this receivable. Given the clarity of Elicker's pretrial deposition, his absence at trial, the testimony of Conway that such an entry would not have been made for about ten days after year-end, and the findings shortly to be described concerning Egli's year-end memo, the preponderance of the evidence weighs on the side of the existence of the booking.

Just after the meeting, on behalf of Muller the following request was made to the French government for approval of the transaction:

> [SCM] has come to an agreement with Mr. Norman Muller, a U.S. citizen, under which the Group of the latter will take over the SCM copier business in some of the European countries, i.e., West Germany, Belgium, the United Kingdom, Switzerland, and France.

As the negotiations were being held DeMaio telexed to Mita seeking to complete the plain paper copier transaction and confirming a Letter of Intent between Reprosystem and Mita for the purchase of about $6,000,000 worth of plain paper copiers from Mita. On December 16 DeMaio also notified Mita that

> we have agreed, on December 15, 1976, to the final terms and conditions pertaining to the sale of the six European companies and the distribution right in all other countries in all of Europe, the Middle East and Africa.

While the negotiations were in progress, DeMaio had prepared a telex for the managers keeping them advised of the events. Rodich approved the telex and it was transmitted on December 17. It read:

> This is a brief report on the status of our negotiations to sell the Europe, Middle East and African copier group to N. Norman Muller.
>
> I am sure you appreciate that the complexity of the transaction has made negotiations and workload much more extensive than anyone anticipated. However, we now feel that the problems are resolved and that the deal is made subject to approval by various government agencies.

Before year end the DeMaio letter to Mita was reviewed by Rodich and the SCM inside counsel. They perceived the danger of a long term commitment, as did Muller who on December 20 rejected any responsibility prior to taking title. SCM urges that this refusal by Muller evidences the lack of an agreement. A more rational inference is that Muller merely sought to defer his obligations until the expected closing. On December 28 Rodich wrote to Mita as follows:

> I have had an opportunity to review Mr. F. D. DeMaio's letter of December 16, 1976, with which he transmitted a 'Letter of Intent' in the name of Reprosystems, B.V. for the purchase of Copystar Model 251R.
>
> As you are aware, SCM is in the process of selling its Euroepan based office copier business to Reprosystems, B.V. We have every reason to believe that this sale will be consummated; however, it is not possible to accurately state when the transaction will be completed.
>
> We want to be sure that you understand that Mr. DeMaio's communication was on behalf of Reprosystems, B.V. and not SCM Corporation and that performance under the 'Letter of Intent' is a legal and financial responsibility of Reprosystems B.V.
>
> Reprosystems will be licensed by SCM to use its trademarks on copier products sold through the or-

ganizations which they will be acquiring. We understand that Reprosystems, B.V. intends to strengthen and expand its copier business, and we hope that Mita and Reprosystem will have a long and mutually profitable relationship.

After the negotiations of December 15 and 16 Egli again sought reassurance with respect to Muller's financial capacity and requested a financial statement which he said would be reviewed only by Rodich and Elicker and be held in confidence. This statement, supplied by Muller on December 20, 1976, showed a net worth of $6,179,000. History and the vigor of SCM's counsel has revealed that these assets were overstated, including as they did certain assets of Muller's wife and some evaluations of control stock that could have been the subject of varying opinions. In fact, on the same day, in connection with anticipated bank financing, Muller submitted more conservative figures to the Chemical Bank, which presumably had previously acquired data on Muller's assets. Muller set forth a net worth of $3,617,000 to the bank. However, in December, 1976 SCM chose not to pursue any further inquiry into Muller's finances.

On December 27 Sullivan & Cromwell provided what in the lexicon of this litigation have been termed the Final Drafts of the Global Agreement, and the French, Belgian, German and Swiss Purchase Agreements. On January 5 these were supplemented by the Final Drafts of the United Kingdom and Chur Asset Purchase Agreements. These Final Drafts, accomplished in the manner described, constituted written agreements between the parties on all material terms relating to the proposed sale, and it was so understood by all those involved as the morning of December 31, 1976. It was also expected and understood that these Final Drafts might be subject to some minor changes and that they would be executed in the near future. The Global Agreement contained standard language to the effect that it as well as each of

the Purchase Agreements would become binding only upon execution.

Counsel's notes indicate certain reservations of Muller's counsel concerning the non-competition, dividend limitations, severance liability, and SCM indemnity clauses in the Final Drafts, but no testimony was adduced to establish that these represented serious, deal-breaking issues for Muller. Indeed the most serious of these issues from SCM's professed point of view, the employee severance liability, engendered simply a query. The other clauses had been previously discussed and resolved so that renegotiation was not likely, despite the mark-ups made by Palley, one of Muller's counsel. In view of Muller's testimony concerning his own understanding of the transaction after the meeting of December 15 and 16 and Palley's testimony, the latter's notes represent no more than a careful lawyer's review in preparation for a further discussion with either his client or the other side, neither of which took place. Although some uncertainty existed with respect to the tax results of the French transaction and the time by which the necessary Bank of England approval could be obtained, these uncertainties were to be resolved by third parties and the preponderance of the evidence does not establish that these uncertainties were sufficient to negate the understandings set forth in the Final Drafts.

The Disagreement and Events in 1977

In accordance with his practice of reviewing financial matters at the end of each quarter and in order to familiarize himself with the transaction, Egli took home on New Year's Eve certain of the documents relating to the proposed sale to Muller. He reviewed the transaction and then made notes of his findings. These notes became the basis of his recommendation to Elicker on January 3. The handwritten notes were introduced, and the alternatives as viewed by Egli were described as follows:

Present Alternatives

1) Resolve open [Muller deal] issues & get contract signed (good for Muller not good for SCM).

2) Slow down on signing contract & send team to Europe to study other approaches to liquidating our investment.

3) Ask for cash payment put into escrow.

4) Kill deal and:

a) Try to spend $2.0-$2.5 [million] in liquidation before 6/30/77 to reduce taxes.

b) Develop a specific plan for each disposition separately.

These alternatives and the financial implications were discussed with Elicker and Hall, Senior Vice President-Administration of SCM on January 4, 1977. Although there is no report of the substance of any internal SCM discussions concerning the finances of the copier business, by year-end it was apparent to Egli that net income for the first half of the fiscal year would be in the neighborhood of $500,000, almost the prior estimate of $600,000 in profits for the entire year. By the projected closing date Egli estimated profits of over $1.2 million. Given the cash implications of the transaction, to be discussed below, it is inferred that these calculations resulted in Egli's conclusion that the deal was "good for Muller, not so good for SCM." Egli testified that at the January 4 meeting, it was determined that SCM would proceed with the deal, attempting to resolve all open issues. In that connection Egli presented at the meeting the following items, first noted in his December 31 memo:

1. Accrued vacation and holiday pay.

2. Interest on purchase price from 8/31.

3. 8/31 audit adjustments and calculation of purchase price.

4. Muller's ability or willingness to finance as necessary.
5. Timing of close—now after 3/31/77.
6. PPC's. [plain paper copiers]
7. Which [general managers] are going with Muller . . . .
8. Gov't approvals.

Only one of these issues—interest on the purchase price—had not been the subject of previous discussion, and none represented material issues beyond resolution except perhaps whatever was indicated by the item "PPC's" but in any case this item was not amplified or explained on January 5 when Egli met with Muller and his counsel Kay.

Prior to that meeting and subsequent to his meeting with Elicker, Egli met with counsel from Sullivan & Cromwell, and all open items were discussed. No testimony has been adduced that there was discussion at that meeting to the effect that the deal should be killed, and indeed there is no direct testimony from any SCM witness that the formal termination of negotiations which occurred later on February 2, 1977 resulted because of an intention of SCM to defeat the transaction.

From January 4 to February 2, 1977 events moved rapidly and quite inexorably. Despite Muller's belief that Egli's function was simply to conclude the arrangements, Egli at the January 5 meeting placed unresolved issues on the table adding four additional items to those he had noted over the weekend. Kay, having returned from the holidays, did not rejoin but merely recorded the positions taken by Egli. In the course of this meeting Egli stated his intention to visit the subsidiaries, a trip to which Muller objected, stating that it made more sense to accelerate the paperwork and complete the transaction. Egli insited on the trip, the purpose of which was not satisfactorily explained by Egli at that time or

at trial. DeMaio objected to the trip, carried his objections to Elicker and was overruled. DeMaio heard immediately after the trip from the managers of the subsidiaries who told him that Egli had indicated serious doubts about the completion of the transaction.

On January 11, William Cawley, Vice President and Treasurer of SCM, wrote to Muller and suggested that the SCM policy relating to equipment held for lease had not been complied with and that certain action would be taken. The letter further stated:

> As you know, the contract requires SCM to carry on the business of the European companies in the ordinary course during the period between September 1 and closing. Our lawyers tell us that since those instructions may be construed to be not in the ordinary course that we should request your consent.

In fact, the evidence at trial established that Rodich had authorized the "additional investments" which were the subject of the letter.[4] The letter is significant since Cawley testified by deposition that it was written at Egli's request and during his European trip. The inference is thus drawn that after consultation with counsel, Egli viewed the Final Drafts as a contract and had embarked upon a change of direction for the European subsidiaries.

Egli then for the first time sought evidence of Muller's capacity to pay the cash required at closing, discussing the transaction with officers of the Chemical Bank. The bank provided Muller with an informal non-binding commitment letter dated January 20, 1977 which was turned

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[4] Cawley's request was for a waiver of the regular course of business representation as affected by a repetition of the freeze on acquiring new equipment which had been in effect throughout fiscal 1976-77. The freeze, part of SCM's investment plan, had been modified in operation by an understanding reached between DeMaio and Rodich that new equipment for lease would be acquired if necessary to satisfy old and important customers.

over to SCM. Although SCM also used the resources of the Chemical Bank and although Conway of SCM had been in touch with the bank on the subject of Muller's financing, no further inquiries were made. In fact, unbeknownst to SCM, Muller had obtained the letter from Chemical on the understanding that the cash in the subsidiaries to be acquired would immediately be used to pay the purchase price advanced by the bank, an understanding which gave rise to serious questions raised by SCM after the litigation had commenced and which are dealt with below. Although the closing date had been fixed at March 31, Egli insisted, without objection by Muller, on its advance to February 28.

The purchase price and the attendant cash required to close had been the subject of calculations by the accountants on more than one occasion. Both Evans, representing Muller, and Conway of SCM were in agreement on the values of August 31, 1976, and the formula to obtain adjustments to make these numbers current as of the closing date. Indeed the variation between the calculations as of the end of August and those at the end of November and December was relatively insignificant, the cash required to close hovering around $4.25 million. However, this figure took a significant jump in January. This increase resulted from a recalculation of certain Swiss accounts receivable prior to August 31, and most signicantly from the demand for interest on the purchase price, approximately $145,000, and the request for $540,000 which resulted from an inter-company transfer. This transfer involved a loan from the German subsidiary to a Canadian SCM subsidiary, and the treatment of the exchange rates had significant tax effects. The work papers relating to this transaction were never turned over to Muller's accountants nor was the entry satisfactorily explained—either at the time to Muller's representatives nor during the trial to the court. However, whatever ultimately might have been the accounting ef-

fect of this transaction, Muller agreed to accept the adjustment as presented. There was, however, no agreement on the demand for interest on the purchase price, and no evidence to counter the implication that this was an afterthought intended at the least to offset the profits earned by the subsidiaries.

Throughout the negotiations SCM had undertaken not to compete in the copier field, and indeed its stated purpose had been to withdraw from such competition. In January this stance was altered, SCM seeking to retain the ability to compete in the event that it acquired any copier rights from Xerox as a result of pending litigation.

However, the most significant actions taken by Egli related to operation in the normal course of business. Egli took steps to reduce the leasing of new equipment, presumably to increase cash sales. On January 11, as recountered above, SCM in effect withdrew the representation that the business had been conducted in the normal course. In addition Egli told Muller he intended to go to Europe to discuss the plain paper copier situation with Mita. Muller asked to accompany Egli who refused the request.

The plain paper copier issue had been precipitated by a request by Mita for a letter of credit to cover merchandise to be shipped. SCM, on the horns of a dilemma of its own making, sought to keep the relationship intact and at the same time to minimize capital commitment. On the second trip to Europe in January, Egli negotiated an understanding with Mita that relieved SCM of any substantial ongoing relationship but permitted the subsidiaries to meet their sales commitments. The substance of this negotiation was undertaken under a pledge of secrecy and substantially affected the business, as Egli knew it would.

Upon his return from Europe Egli met with Elicker, Rodich was called back to New York, and it was determined to fire DeMaio and the other New York adminis-

trators of the subsidiaries and their secretaries without discussion with Muller or any prior notice to him, although continuity of management had long been understood to be a consideration for Muller. Egli told DeMaio he was fired and directed that he be escorted out of the building. The firing of DeMaio, previously a well-regarded executive of 11 years' standing,[5] resulted from the bottom line analysis by Egli of the financial results of the transaction and DeMaio's commitment to the continuation of the business on behalf of Muller, a course upon which DeMaio had earlier been set by Rodich in spite of the situation of inherent conflict that this created.

Egli explained the firing as a result of the Mita misunderstanding, a failure to implement the freeze on the leasing of new equipment, and an unconfirmed report that a controller in one of the subsidiaries sought to decrease the cash in the subsidiaries as of August 31, for Muller's benefit and at DeMaio's direction. In fact the freeze policy had been modified by Rodich unbeknownst to Egli, the reported event relating to the August 31 reports did not occur, and the report itself was neither investigated or confirmed. DeMaio's participation in the Mita transactions was known shortly after its occurrence and was faithful to the business-in-the-ordinary-course precept. The reasons given for the firing of DeMaio were pretextual, and therefore constitute significant evidence that Egli indeed sought to kill the deal.

By January 20, SCM issued a press release stating that it felt free to pursue "other alternatives" to a sale to Muller, who at the moment of being informed of this change of position was attendant upon an ill wife. He

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[5] DeMaio testified that though he had not discussed the Muller transaction in detail with Elicker, he had met his chief executive in the hall in December, 1976. Elicker thanked DeMaio for his efforts on the transaction, wished him well in his future endeavors in the same role under Muller's ownership and told him that he well deserved the reward.

asked Conway to modify the language to soften its implication, a request which was refused.

On January 31 Muller wrote to Elicker seeking to enforce the agreement and on February 2 SCM formally terminated the negotiations. At no time did Egli carefully review or discuss the Final Drafts internally; at no time were any of the Final Drafts signed by any of the parties, nor did Muller ever tender the purchase price. In view of what was done as opposed to what may have been said at the meetings held on January 5, 6, 14 and 17, and on February 2, I find that SCM's financial interest required that the sale not go forward, that Egli realized that fact, that the actions taken in January, 1977 by Egli on behalf of SCM had the effect of slowing down the signing and killing the deal, and that a specific plan for disposition of each corporation was evolved, contrary to the Agreement in Principle and the Final Drafts. In other words, the acts performed require the inference that in January the responsible officers of SCM reached a conclusion to terminate the transaction with Muller.

The Ability to Perform the Agreement

Throughout the trial, if not during the negotiations, SCM insisted that Muller lacked the capacity to perform the transaction, and factual findings on this issue are required. At the outset it was understood that SCM was concerned about two significant items, its potential employee severance liability of approximately $6 million and its continuing bank guarantees. After Muller's refusal to give an undertaking to continue in business for three years and a personal guarantee, SCM sought security for the transferred companies through the restrictive provisions on pledges, loans and dividends described above, recognizing that the form of the transactions and the continuation of the companies in business with adequate funding were significant to its concerns.

As to the liability on bank guarantees, early on Muller undertook to have SCM removed from the guarantees.

The pro forma financials submitted to the Chemical Bank in January in order to elicit its informal letter of commitment revealed short term loans of $2,363,000 as of November 30, 1976 as a liability of the new companies.[6]

Throughout the negotiations the requirement to produce a certified check at closing was the only provision relating to Muller's ability to close the transaction, other than the somewhat informal required financial representations already referred to. As evidenced by Muller's submissions to the Chemical Bank on January 7 it was his intention, at least at that point, to provide the cash required to close by a bridge loan, to be repaid out of the cash on hand in the acquired companies. In view of the facts now found, it is not necessary to determine the exact amount of cash required to close. If the transaction had gone forward on the basis of the Final Drafts, that amount would have been in the neighborhood of $4.5 million. Had all SCM's proposed accounting charges been accepted that amount would have been increased by approximately $1 million.

A substantial amount of testimony was adduced by both sides on the subject of Muller's capacity to perform the agreements represented by the Final Drafts. This included the refusal of Citibank in the early fall to provide financing and a similar refusal by the Chemical Bank International Division, though these refusals are by no means conclusive evidence on Muller's ability to finance the transaction. Citibank was dealing with different facts than those which were present in December, and Chemical had internal reasons for refusal. Nonetheless, these re-

[6] Egli on many occasions during the trial stressed his concern about SCM's liability on these guarantees. However, the guarantees were not the subject of identified documents, nor had they been tabulated and presented to Muller. No objective reason was advanced to indicate that any difficulty would be encountered in getting SCM off the guarantees other than the observation that SCM was a substantial corporation, and Reprosystem was not. Egli testified that Muller did nothing to accomplish the agreed upon substitution. Neither did SCM, which according to Egli would have had a far greater interest in the matter.

fusals do establish that financing for a $5 million transaction cannot be assumed.

It was agreed by certain witnesses for each side that some mention was made by Muller's representatives that they might seek to use the cash in the German company in connection with financing the purchase price. Muller and his representatives, Kay and Evans, all testified that it was understood by both sides that the cash on hand in the acquired companies could be used to finance the purchase price, and it is certain that some discussion along these lines, at least with respect to the German company, did take place. A review of the documentary evidence also establishes a preponderance of evidence that the issue was discussed, particularly in connection with the restrictive provisions which occupied a considerable amount of time in negotiation and drafting. The notes and recollection of Kay, Muller's counsel, are supported by a parallel reference in the notes of SCM's outside counsel relating to the same provision at the same meeting. In the vocabulary of the parties the entry "Purchase price may leave the pool" establishes the fact that the cash in the subsidiaries was considered with respect to Muller's financing, despite the inability of counsel for SCM to recall the significance of the phrase.

However, even though I find that this method of financing the purchase price was discussed between the parties, the discussion is relatively unimportant. SCM at no time sought to inhibit any such financing. The testimony concerning the commonality of such a practice is undisputed, and SCM could hardly be characterized as an ill-advised seller. There was no prohibition in the Final Drafts or in the discussions of the parties barring Muller from using the cash in the subsidiaries to assist in the financing of the purchase price.[7]

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[7] Although such a gloss might be sought to be imposed upon the restrictive provisions, the language of the provisions reads otherwise.

Of course, in the light of the facts so far as found, it is obvious that Muller's ability to perform the contract he alleges cannot be established by anything that actually occurred, but rather by an assessment of what in all probability would have occurred. It is undisputed that Muller did not tender a certified check in the amount of the cash required at closing as it was calculated as of December 31, 1976 or for any other amount which might have been determined. Indeed, outside of the projected financing, no direct evidence was presented to establish that a source was available to provide the $4 million plus which would have been required. Muller's informal bank commitment letter from Chemical was just that. No commitment fee had been paid, and Chemical was not bound to produce the financing. Further, the projected financing depended on cash remaining in the companies to be sold.

Both Rodich and Muller testified that Muller had agreed to eliminate SCM's liability on the bank guarantees and that such a result could be achieved either by paying the loans or relieving SCM of its liability. It would not have violated the understanding between the parties for SCM to have required the subsidiaries to pay off the short term loans and overdrafts prior to closing, or to require Reprosystem to do so immediately after closing should the banks be unwilling to release SCM from its guarantees. SCM has successfully demonstrated that such an event would have stripped the subsidiaries of cash. Under such cirumstances the contingent nature of the Chemical's informal commitment does not rise to the level of proof that Reprosystem would have been able to perform the contract and provide the necessary cash at closing. That Muller had assets, there is no doubt, but no direct evidence was presented as to the amount of cash which could have been generated by the use of these assets. Similarly, though the subsidiaries undoubtedly had value, no direct evidence was presented that any particular financial sources would have provided the bridge financing necessary. The commercial reality of Muller's

ability to close the transactions was not established by a preponderance of the evidence.

CONCLUSIONS OF LAW

The facts as found above do not lead to simple conclusions of law, to be recited as first principles, known and recognized from the beginning of recorded legal history. What has been described is the complicated interaction which takes place when major corporations dispose and acquire substantial assets. Such transactions require lines to be drawn, projected from earlier established principles which then define duties and obligations perhaps not previously perceived or articulated as such.

In this instance the parties in December, 1976, agreed upon all material terms of a contract which was to be embodied in a final agreement to be executed. An agreement was reached, and that agreement required the good faith action of both parties to complete the transaction. SCM's acts from December 31 are inconsistent with its duty to perform its agreement to act in good faith. SCM has been unjustly enriched with profits earned on Muller's account, and must disgorge those profits as the most readily available approximation of the relief to which Muller is entitled in damages and restitution. On the other hand, given the failure of Muller to establish that Reprosystem was ready, willing and able to perform the bargain, Muller is not entitled to damages based on any profit which he might achieve had the end-transaction been performed, or full expectation damages measured in any other way.

SCM's acts, described above, while in violation of its obligations to Reprosystem, were motivated not by an intent to defraud or deceive but simply out of a careful financial analysis, not rising to the level of fraud under the securities laws or common law. It seems almost implicit that the federal claim, though facially sufficient, served principally to establish initial jurisdiction, which

was accomplished without objection or motion. The claim, however, is insufficient both as a matter of law and fact.

The Securities Claim

If the strict language of Section 10(b) of the Securities Exchange Act of 1934 ("the 1934 Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, were to be applied automatically because a sale of securities was contemplated, then virtually every sale of a business structured as was this transaction would call into play the panoply of rights and remedies under the securities law. An examination of the essential purpose of such laws is required whenever this outreach is sought.

The subject matter of this lawsuit is the purchase and sale of a business, even though that purchase and sale in part involved a transfer of ownership evidenced by stock. Recently, the Seventh Circuit Court of Appeals confronted the question of "whether alleged fraud regarding the sale of assets and stock in a corporation falls within the scope of [the federal securities] laws." In *Frederiksen v. Poloway*, 637 F.2d 1147, (7th Cir. 1981), *cert. denied*, —— U.S. ——, 101 S.Ct. 3006, 69 L.Ed.2d 389 (1981), it was held that the acquisition of a marina did not involve a "security" within the purview of the federal securities law. The court, at 637 F.2d 1150, quoted the following observation of the Supreme Court in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 849, 95 S.Ct. 2051, 2059, 44 L.Ed.2d 621 (1975):

> The primary purpose of the Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors.

The *Frederiksen* court noted further the conclusion of the Court in *Forman* that the securities laws do not apply

when the goal of a purchaser is not investment, but a desire to "use or consume the item purchased." 637 F.2d at 1150, *quoting* 421 U.S. at 852-53, 95 S.Ct. at 2060-61.

The 1934 Act provides that "[t]he term security means any . . . stock," 15 U.S.C. § 78c(a)(10); but that definition, as are all the definitions in § 78c(a), is preceded by the prhase "unless the context otherwise requires;" the definition of "security" in the 1933 Act is prefaced by the same phrase, 15 U.S.C. § 77b(1). Although the transaction involved in *Frederiksen* appeared to be within the letter of the 1934 Act it was not—given the commercial as opposed to investment character—within the spirit, nor within the intention of its makers. *Id.* at 1150. Indeed, as the *Frederiksen* court noted, the "literal application" argument was specifically rejected by the Court in *Forman, supra,* 421 U.S. at 848, 95 S.Ct. at 2058, in the following terms:

> We reject at the outset any suggestion that the present transaction evidenced by the sale of shares called 'stock,' must be considered a security transaction simply because the statutory definition of a security includes the words 'any . . . stock.' Rather we adhere to the basic principal that has guided all of the Court's decisions in this area:
>
> > '[I]n searching for the meaning and scope of the word "security" in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality.' *Tcherepnin v. Knight,* 389 U.S. 332, 336 [88 S.Ct. 548, 553, 19 L.Ed.2d 564] (1967).

As in *Frederiksen,* the "economic reality" of this transaction was that Muller intended to manage and operate the business and had no intention to rely on the present and future efforts of SCM to produce profits. Thus, the securities law claim fails for the reason that the contemplated transaction did not involve an investment of money

in a common enterprise from which the profits were expected "to come solely from the efforts of others." *Int'l Brhd. of Teamsters v. Daniel,* 439 U.S. 551, 558 & n.11, 99 S.Ct. 790, 815, 58 L.Ed.2d 808 (1979), *quoting Forman, supra,* 421 U.S. at 851-522, 95 S.Ct. at 2060; *SEC v. W. J. Howey Co.,* 328 U.S. 293, 301, 66 S.Ct. 1100, 1104, 90 L.Ed. 1244 (1946); *Williamson v. Tucker,* 632 F.2d 579, 592-601 (5th Cir. 1980); *Glen-Arden Commodities, Inc. v. Costantino,* 493 F.2d 1027 (2d Cir. 1974); *Barsy v. Verin,* 508 F.Supp. 952 (N.D. Ill. 1981); *Wieboldt v. Metz,* 355 F.Supp. 255 (S.D.N.Y. 1973).

Further, the claimed frauds of overstated assets and inflated income were not made with the scienter required to be established under the federal securities laws or under the common law. As set forth above, these were projections made in good faith. The profits projection proved to be more or less accurate although SCM management believed otherwise at one time. Although the assets described to Muller in the spring of 1976 may have been overstated by a million dollars, there is no evidence that such overstatement was made with a fraudulent intent or even recklessly. *See Aaron v. SEC,* 446 U.S. 680, 100 S.Ct. 1945, 64 L.Ed.2d 611 (1980); *Ernst & Ernst v. Hochfelder,* 425 U.S. 185 (1976); *Elkind v. Liggett & Myers, Inc.,* 635 F.2d 156, 165 (2d Cir. 1980); *Samuels v. Eleanora Baheer, B.V.,* 500 F.Supp. 1357, 1361-62 (S.D.N.Y. 1980).

Of course, it has been found as fact above that SCM had determined not to complete the transaction after Egli's analysis at the end of 1976. There was no statement to that effect, and SCM sought to imply that it still intended to go forward with the transaction. There was, however, no misrepresentation to that effect. At worst there was a failure to disclose the fact of a decision to "kill the deal." Were the federal securities laws applicable, this omission would require further analysis. In

the last analysis there was no purchase and sale of a security, and despite the dutiful citation of *Omega Executive Services, Inc. v. Grant*, [1979 Transfer Binder] Fed. Sec.L.Rep. (CCH) ¶ 98,848 at 95,445 (S.D.N.Y. 1979) by Reprosystem, the securities laws are thus inapplicable.

The Contract Claim

These conclusions simply return the court to where the parties have been throughout the litigation, the determination of New York law with respect to the rights and liabilities of parties seeking to contract.[8] Several principles of law relevant to the determination of whether a contract existed are urged by the parties as "ancient," "cardinal" and "controlling." As is often the case, initial guidance is derived from Judge Weinfeld:

> The day is long past when a red ribbon and seal is the parties' agreements in order to validate such required upon documents which contain the terms of agreements.

Royal Indemnity Co. v. Westinghouse Elec. Corp., 385 F.Supp. 520, 522 (S.D.N.Y. 1974). Indeed, it is well established that where parties reach an agreement they are bound by it, whatever its form and however it is manifested. *See e.g., Kleinschmidt Div. of SCM Corp. v. Futuronics Corp.*, 41 N.Y.2d 972, 395 N.Y.S.2d 151, 363 N.E. 2d 701 (1977); *Sanders v. Pottlitzer Bros. Fruit Co.*, 144 N.Y. 209, 39 N.E. 75 (1894).

What is looked to in determining whether an agreement has been reached is not the parties' after-the-fact professed subjective intent, but their objective intent as

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[8] The parties have relied on New York law in support of their respective positions on the contract issue, assuming accurately that it would govern in this action where Muller and SCM are New York residents, virtually all of the negotiations and contracts drafting took place here, and the various contract drafts all specify that New York law should govern disputes arising thereunder.

manifested by their expressed words and deeds at the time. *Brown Bros. Electrical Contractors, Inc. v. Beam Constr. Corp.*, 41 N.Y.2d 397, 393 N.Y.S.2d 350, 352, 361 N.E.2d 999, 1001 (1977). If the parties' expressions and conduct would lead a reasonable man to determine that they intended to reach a binding agreement, their agreement will be enforced. *Phillip v. Gallant*, 62 N.Y. 256, 263 (1875). In determining whether the parties entered into a contractual agreement and what were its terms,

> disproportionate emphasis is not to be put on any single act, phrase, or other expression, but, instead, on the totality of all of these, given the attendant circumstances, the situation of the parties, and the objectives they were striving to attain [citations omitted].

Brown Bros., supra, 393 N.Y.S.2d at 352.

Moreover, while there is no enforceable agreement if the parties have not agreed on the essential terms, *Interocean Shipping Co. v. Nat'l Shipping & Trading Co.*, 462 F.2d 673, 676 (2d Cir. 1972); *ABC Trading Co. v. Westinghouse Elec. Supply Co.*, 382 F.Supp. 600 (E.D.N.Y. 1974), in New York and across the country a binding contract can be formed despite "material open issues." *See e.g.*, N.Y.U.C.C. ("UCC") 2-204, (McKinney 1964). As the New York Court of Appeals held in *Kleinschmidt, supra*:

> Under the Uniform Commercial Code [2-204(3)], if the parties have intended to contract, and if an appropriate remedy may be fashioned, a contract for sale does not fail for indefiniteness if terms, even important terms, are left open .... It is no longer true that dispute over material terms inevitably prevents formation of a binding contract. What is true . . . is that when a dispute over material terms manifests a lack of intention to contract, no contract results.

. . . . .

> Thus, when there is basic agreement, however manifested and whether or not the precise moment of agreement may be determined, failure to articulate that agreement in the precise language of a lawyer, with every difficulty and contingency considered and resolved, will not prevent formation of a contract . . . .

395 N.Y.S.2d at 152, 363 N.E.2d at 702. If the parties fail to work every aspect of the agreement out, such terms can be resolved by the court. *See e.g., United States v. Bedford Associates,* 657 F.2d 1300 at 1310, 1311 (2d Cir. 1981); *V'Soske v. Barwick,* 404 F.2d 495 (2d Cir. 1968); *American Cyanamid Co. v. Elizabeth Arden Sales Corp.,* 331 F.Supp. 597 (S.D.N.Y. 1971). Even failure to agree expressly on the payment terms does not alone prevent an enforceable agreement. *Rose v. Spa Realty Associates,* 42 N.Y.2d 336, 397 N.Y.S.2d 922, 366 N.E.2d 1279 (1977).

It is recognized that if the parties intend not to be bound until they have executed a formal document embodying their agreement, they will not be bound until then. *Int'l Telemeter Corp. v. Teleprompter Corp.,* 592 F.2d 49, 56, and 57-58 (Friendly, J. concurring); *V'Soske, supra,* at 499; *Chromalloy American Corp v. Universal Housing Systems of America, Inc.,* 495 F.Supp. 544, 550 (S.D.N.Y. 1980); *Scheck v. Francis,* 26 N.Y.2d 466, 311 N.Y.S.2d 841, 260 N.E.2d 493 (1970); UCC 2-305(4); Restatement (Second) of Contracts § 32, comment c (Tent. Drafts 1-7, 1973); 1 Williston on Contracts § 28 at 66-67 (3d ed. 1957). On the other hand the mere fact that the parties contemplate memorializing their agreement in a formal document does not prevent their less formal agreement from taking effect prior to that event. *Teleprompter, supra*; *V'Soske, supra*; *Banking & Trading Corp. v. Floete,* 257 F.2d 765, 769 (2d Cir. 1958); *see also Sommer v. Hilton Hotels Corp.,* 376 F.Supp. 297 (S.D.N.Y. 1974); *Tymon v. Linoki,* 16 N.Y.

2d 293, 266 N.Y.S.2d 357 (1965); *APS Food Systems, Inc. v. Ward Foods, Inc.*, 70 A.D.2d 483, 421 N.Y.S.2d 223 (1st Dep't 1979); *S. J. Groves & Sons Co. v. L. M. Pike & Son, Inc.*, 41 A.D.2d 584, 340 N.Y.S.2d 230 (4th Dept. 1973); *Zirman v. Beck*, 34 Misc.2d 597, 225 N.Y.S. 2d 330 (Sup.Ct.Bronx.Co. 1962); *Karson v. Arnow*, 32 Misc.2d 499, 224 N.Y.S.2d 891 (Sup.Ct.N.Y.Co. 1962). As put succinctly by Professor Corbin:

> The parties have power to contract as they please. They can bind themselves orally or by informal letters or telegrams if they like. On the other hand, they can maintain complete immunity from all obligation, even though they have expressed agreement orally or informally upon every detail of a complex transaction. The matter is merely one of expressed intention. If their expressions convince the court that they intended to be bound without a formal document, their contract is consummated, and the expected formal document will be nothing more than a memorial of that contract. [footnote omitted].

1 A. Corbin Contracts, § 30 at 98-99 (2d ed. 1963).

Again, these rules are but aspects of a broader governing principle which looks to reality and substance in a transaction, not form. As noted in *V'Soske, supra*, 404 F.2d at 499:

> Contract law has progressed and evolved sounder principles since the days of ritualistic and formalistic sealed instrument requirements. Thus, these rules, placing the emphasis on intention rather than form, are sensible and reasonable.

This objective theory of contracts was stated by Judge Learned Hand in *Hotchkiss v. National Bank of New York*, 200 F. 287, 293 (S.D.N.Y. 1911), aff'd, 201 F. 664 (2d Cir. 1912), *aff'd*, 231 U.S. 50, 34 S.Ct. 20, 58 L.Ed. 115 (1913), as follows:

> A contract has, strictly speaking, nothing to do with personal, or individual, intent of the parties. A contract is an obligation attached by the mere force of law to certain acts of the parties, usually words, which ordinarily accompany and represent a known intent. If, however, it were proved by twenty bishops that either party, when he used the words, intended something else than the usual meaning which the law imposes upon them, he would still be held, unless there were some mutual mistake, or something else of the sort.

See Brown Bros., supra, 393 N.Y.S.2d at 351-52, 361 N.E.2d at 1000-02.

In a series of decisions which I find controlling here, our circuit has applied this objective theory of contracts to various transactions, some involving the transfer of substantial business entities, and found a contract to exist from an oral or informal agreement.

In *American Cyanamid Co. v. Elizabeth Arden, supra,* it was held that in a letter agreement for the purchase of a "far flung business" from a large and sophisticated corporation for about $35,000,000, it was not fatal to fail to include representations and warranties, to leave to further negotiations questions relating to an escrow fund for the purchase price, to fail to establish accounting principles to verify the net worth, and to omit the closing date. Similarly, an oral contract with Joseph E. Seagram & Sons, Inc. to provide the plaintiff with an opportunity to purchase a wholesale liquor distributorship of an approximate value and profit potential within a reasonable time has been upheld as sufficiently definite to be enforceable. *Lee v. Joseph E. Seagram & Sons, Inc.,* 413 F.Supp. 693 (S.D.N.Y. 1976), *aff'd,* 552 F.2d 447 (2d Cir. 1977).

In *V'Soske, supra,* an informal exchange of "correspondence" resulted in an enforceable contract for the purchase of a business for approximately $1.7 million,

even though the parties contemplated the subsequent execution of a formal written agreement. In *Teleprompter, supra*, International Telemeter and Teleprompter had engaged in a sequence of negotiations over the terms of an agreement settling complex patent litigation. A series of drafts of the settlement agreement was exchanged, and the parties orally agreed on the terms of the settlement. However, prior to delivery of the signed settlement documents, new management at Teleprompter refused to proceed with the settlement agreement. The Second Circuit upheld the District Court's finding under New York law that since the parties had reached a final agreement and had manifested objective indications of their intent to be bound, the settlement agreement would be enforced. In *Viacom Int'l, Inc. v. Tandem Productions, Inc.*, 526 F.2d 593, 595-96 (2d Cir. 1975), an oral agreement governing distribution and syndication rights for the television program "All In The Family" was held to be binding. *Accord, Ellis Canning Co. v. Bernstein*, 348 F.Supp. 1212 (D.Colo. 1972); *Itek Corp. v. Chicago Aerial Industries, Inc.*, 248 A.2d 625 (Sup.Ct.Del. 1968).

Thus, the objective manifestations of SCM and the plaintiffs must be weighed by the court and the line drawn between the competing principles set forth above. The weighing has been done, and it has been determined as a matter of fact that eventually both parties intended to be bound by the Final Drafts. Taking into account the totality of the parties' objective manifestations of intent as the transaction progressed and the circumstances surrounding the negotiations, I reject SCM's contention that a final signing would be required to constitute a binding agreement. In the circumstances at bar, SCM's—indeed, both parties'—contemplation of subsequent formal signed agreements did not overcome the objective facts which established an agreement. Implicit here, as well, is my conclusion that none of the contract terms which remained open after consensus was reached on the Agreement in Principle and then on the Final Drafts were such, taken

separately or together, as to prevent the agreements from taking effect. The indefiniteness of the purchase price was insignificant in light of the formula provided by the parties for the court, if necessary, to give content to that term. *United States v. Bedford Associates, supra,* 657 F.2d at 1310. Additionally, the alleged need for SCM Board approval of any final agreements, *e. g. Ashton v. Chrysler Corp.,* 261 F.Supp. 1009, 1013 (E.D.N.Y. 1965); *Weisner v. 791 Park Avenue Corp.,* 6 N.Y.2d 426, 434, 190 N.Y.S.2d 70, 75-76, 160 N.E.2d 720, 724 (1959), is without significance here, given the language of the Final Drafts and the involvement of the Board in the agreements already reached.

Nor is the existence of the agreement defeated by the requirements of the statute of frauds. Indeed, SCM does not seriously dispute the point.[9] It is well-established un-

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[9] The arguably relevant statute of frauds provisions are the following, which provide, in full or in pertinent part:

N.Y.G.O.L. § 5-701 (McKinney, Supp. 1980):

(a) Every agreement, promise or undertaking is void, unless it or some note or memorandum thereof be in writing, and subscribed by the party to be charged therewith, or by his lawful agent, if such agreement, promise or undertaking:

(1) By its terms is not to be performed within one year from the making thereof....

N.Y.U.C.C. § 1-206 (McKinney 1964):

(1) Except in the cases described in subsection (2) of this section a contract for the sale of personal property is not enforceable by way of action or defense beyond five thousand dollars in amount or value of remedy unless there is some writing which indicates that a contract for sale has been made between the parties at a defined or stated price, reasonably identifies the subject matter, and is signed by the party against whom enforcement is sought or by his authorized agent. (2) Subsection (1) of this section does not apply to contracts for the sale of goods (Section 2-201) nor of securities (Section 8-319) nor to security agreements (Section 9-302).

N.Y.U.C.C. § 2-201 (McKinney 1964):

(1) Except as otherwise provided in this section a contract for the sale of goods for the price of $500 or more is not enforce-

der New York law that the memorandum required by the statute of frauds need not be incorporated in a single document, but may be derived from several documents which relate to each other, only one of which need be prepared by the defendant. *Weitnauer Trading Company Ltd. v. Annis*, 516 F.2d 878, 880 (2d Cir. 1975); *Great Destinations, Inc. v. Transportes Aereas Portuguese S.A.R.L.*, 460 F.Supp. 1160 (S.D.N.Y. 1978); *Crabtree v. Elizabeth Arden Sales Corp.*, 305 N.Y. 48, 110 N.E.2d 551 (1953); *APS Food Systems, supra*, 421 N.Y.S.2d at 225. The court in the *Crabtree* case thus recognized that the law "permit[s] the signed and unsigned writings to be read together, provided that they clearly refer to the same subject matter or transaction." 305 N.Y. at 55, 110 N.E.2d 551.

The statute of frauds requirements have been satisfied by the Final Drafts and the acts of SCM as found above, including the December 17, 1976 telexes to the general managers of the copier subsidiaries, the December 16, 1976 letter signed by Frank DeMaio to Mita Holland B.V., the testimony concerning the meetings of December 15 and 16 and the documents prepared on or about

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able by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

N.Y.U.C.C. § 8-319 (McKinney 1964):

A contract for the sale of securities is not enforceable by way of action or defense unless

(a) there is some writing signed by the party against whom enforcement is sought or by his authorized agent or broker sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price....

December 31, 1976 by Herbert Egli, referring to "the deal."

However, although under these principles a contract has been established, the matter does not end there. Even having established an enforceable agreement a plaintiff cannot be allowed to recover for an alleged breach of contract unless he can establish by a preponderance of the evidence that the defendant would have received "substantially what he bargained for." 6 Williston, *supra*, § 884 at 402. *See United States v. Penn Foundry & Mfg. Co.*, 337 U.S. 198, 69 S.Ct. 1009, 93 L.Ed. 1308 (1949); *United States Overseas Airlines, Inc. v. Compania Aerea Viajes Expresos de Venezuela, S.A.*, 246 F.2d 951, 952 (2d Cir. 1957); *Hodes v. Hoffman Int'l Corp.*, 280 F.Supp. 252, 258-59 (S.D.N.Y. 1968). Here, under both common law and the UCC, the spurned buyer's right of action for anticipatory breach depends on his shouldering the burden of demonstrating his readiness, willingness and ability to tender performance when due. *See Scholle v. Cuban-Venezuelan Oil Voting Trust*, 285 F.2d 318 (2d Cir. 1960); *Decor by Nikkei Int'l, Inc. v. Federal Republic of Nigeria*, 497 F.Supp. 893, 907-908 (S.D.N.Y. 1980), *aff'd*, 647 F.2d 300 (2d Cir. 1981); *UFITEC, S.A. v. Trade Bank & Trust Co.*, 21 A.D.2d 187, 249 N.Y.S.2d 557 (1st Dep't 1964), *aff'd*, 16 N.Y.2d 698, 261 N.Y.S.2d 893 (1965).

The aggrieved plaintiff does not, in order to satisfy his burden, have to actually tender a performance which has been rendered futile by defendant's repudiation, *Scholle, supra*; *Allbrand Discount Liquors, Inc. v. Times Square Stores Corp.*, 60 A.D.2d 568, 399 N.Y.S.2d 700 (2d Dep't 1977); *UFITEC, supra*, 249 N.Y.S.2d at 560. Further, plaintiff's burden upon anticipatory repudiation by defendant could be satisfied by a showing that defendant, by his actions, rendered performance by plaintiff impossible. *Amies v. Wesnofske*, 255 N.Y. 156, 162-63, 174 N.E. 436 (1931). However, this record fails to establish

that sort of impossibility. Here, I have found as a matter of fact that, quite apart from any wrongs committed by SCM, Muller has failed to demonstrate by a preponderance of the evidence that he possessed the ability to come up with the cash at closing. This failure bars enforcement of the otherwise enforceable agreement.

The Duty to Perform in Good Faith

On the facts as I have found them, I conclude not only that SCM breached the agreements reached at the end of 1976, but that it specifically breached its duty of good faith negotiation and performance required by those agreements. A fundamental obligation to deal in good faith, found in established case law, required SCM to act otherwise than to single-mindedly bail out of what it came to see as a bad deal.

Itek Corp. v. Chicago Aerial Industries, Inc., supra, presented a similar situation. In that case, Itek, a prospective purchaser of the assets of Chicago Aerial Industries, Inc. ("CAI"), sued for breach of a contract to sell those assets. The parties had arrived at an agreement on the price, which was subject to several conditions including "that formal documents be prepared to the satisfaction of the parties," and they had also signed a "Letter of Intent." Nevertheless, CAI received a better offer from another purchaser, terminated discussions with Itek and sold the assets to the higher bidder. The court held that there was evidence which would support the conclusion that at the time of the Letter of Intent, Itek and CAI intended to be bound to the agreement for the sale of assets, and further that the parties' "Letter of Intent," which set forth the basic terms of their transactions, "obligated each side to attempt in good faith to reach final and formal agreement." 248 A.2d at 625.

While the letter of intent involved in Itek contained an explicit requirement that the parties shall "make every reasonable effort" to close the deal formally, *see also*

Arnold Palmer Golf Co. v. Fuqua Industries, Inc., 541 F.2d 584 (6th Cir. 1976); *Thompson v. Liquichimica of America, Inc.*, 481 F.Supp. 361 (S.D.N.Y. 1979) and 481 F.Supp. 365 (S.D.N.Y. 1979); *American Broadcasting Companies, Inc. v. Wolf*, 52 N.Y.2d 394, 438 N.Y.S.2d 482 (1981), the *Itek* reasoning has been applied in similar commercial settings where the good-faith duty has been enunciated. Thus, in *Pepsico, Inc. v. W. R. Grace & Co.*, 307 F.Supp. 713 (S.D.N.Y. 1969), where the parties had issued a joint press release announcing their "agreement in principle" to sell a controlling interest in a subsidiary of Grace, the court noted Pepsico's argument, based on *Itek*, that the agreement in principle carried with it an obligation to negotiate the terms of a definitive agreement in good faith, and responded as follows:

> Assuming that there was a binding agreement on May 8th [the date the agreement in principle was announced], we would agree that an obligation to negotiate in good faith was implied. . . .

Id. at 720. *See also American Cyanamid, supra*, 331 F. Supp. at 606; Knapp, Enforcing the Contract to Bargain, 44 N.Y.U.L. Rev. 673, 716-23 (1969).[10]

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[10] Professor Knapp who in his article advocates the enforcement of a preliminary agreement in such a context specifically as a contract to bargain, offers the following expression of the character of manifestation of intention which would serve to create such a contract:

> The essential question is whether the parties have expressed both satisfaction with and commitment to the essential terms of the proposed transaction, to the extent that each would reasonably regard the other as unjustified in withdrawing for any reason other than a failure—after negotiation in good faith—to arrive at a complete and final agreement (footnote omitted).

44 N.Y.U.L.R. at 720. After some analysis, he suggests additionally:

> [A] contract to bargain is likely to be enforced only where there has been either a unilateral withdrawal from negotia-

Indeed, under New York law, every contract carries with it an implied obligation of good faith. *Lowell v. Twin Disc, Inc.*, 527 F.2d 767, 770-71 (2d Cir. 1975); *Niagara Mohawk Power Corp. v. Graver Tank & Mfg. Co.*, 470 F.Supp. 1308, 1316 (N.D.N.Y. 1979); *Joseph E. Seagram & Sons, Inc.*, *supra*, 413 F.Supp. at 698; *Sommer v. Hilton Hotels Corp.*, *supra*, at 301-02; *Matter of DeLaurentiis*, 9 N.Y.2d 503, 215 N.Y.S.2d 60, 63-64, 174 N.E.2d 736, 738-739 (1961); *Baker v. Chock Full O'Nuts Corp.*, 30 A.D.2d 329, 292 N.Y.S.2d 58 (1st Dep't 1968). This obligation has statutory force as well. The policy behind the Uniform Commercial Code is to "give effect to the agreement which has been made . . . conditioned by the requirement of good faith action which is made an inherent part of all contracts within this Act." UCC § 2-305, Official Comment 6 (McKinney 1964). In addition, the Code in § 1-203 specifically provides that "[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."

Thus, while a party to any negotiations for the purchase and sale of property is not automatically obligated to carry the negotiations through to closing, *see Brause v. Goldman*, 10 A.D.2d 328, 199 N.Y.S.2d 606, 611 (1st Dep't 1960), *aff'd*, 9 N.Y.2d 620, 210 N.Y.S.2d 225, 172 N.E.2d 78 (1961), consistent with principles of New York law dating back to *Wood v. Duff-Gordon*, 222 N.Y. 88, 118 N.E. 214 (1917), SCM was obligated to act fairly under the Agreement in Principle and the Final Drafts to negotiate in good faith to finalize matters and then presumably, to accomplish the end transaction.

> tions or at least an insistence on terms so clearly unreasonable that they could not have been advanced with any expectation of acceptance, coupled with some demonstrable advantage to be gained by defendant in avoiding the contemplated transaction.

Id. at 723. *See also* Dugdale and Lowe, Contracts to Contract and Contracts to Negotiate, [1976] J.Bus.Law 28.

The Damages

Although I have concluded that Muller is not entitled to recover his full expectation damages however those might be measured, *compare Lee v. Joseph E. Seagram & Sons, Inc., supra,* 413 F.Supp. at 705-07; *Pennsylvania Co. v. Wilmington Trust Co.,* 39 Del.Ch. 453, 166 A.2d 726 (Ch.Ct. 1960), *aff'd,* 40 Del.Ch. 140, 172 A.2d 63 (Sup.Ct. 1961); *Gold Seal Prods., Inc. v. R.K.O. Radio Pictures, Inc.,* 134 Cal.App.2d 843, 286 P.2d 954 (Dist. Ct.App. 1955), SCM's breach of the agreement reached and the concomitant breach of its good faith obligation entitle Muller to relief.

As the determination of liability on these facts is not simple, neither is the assignment of a proper remedy. The court has not been presented with nor has it discovered a similar case involving on the one hand the bad faith repudiation of a preliminary agreement for the sale of a business, and on the other hand the failure of proof by the would-be purchaser of his own ability to perform when such was to come due. A recovery allowed under these circumstances may be viewed as the appropriate compensation for the defendant's breach of its duty to deal in good faith, *see American Broadcasting Companies, Inc. v. Wolf, supra,* 438 N.Y.S.2d at 485, 487-88; *Knapp, supra,* at 723-26, or, more traditionally, as the appropriate measure of damages, all things considered, for SCM's repudiation of the agreement reached by the parties. *Cf. Fair Sky, Inc. v. Int'l Cable Ride Corp.,* 23 A.D.2d 633, 257 N.Y.S.2d 351, 353 (1st Dep't 1965).

The most logical and readily available measures of damages under these circumstances is the profit earned by SCM in the period before the anticipated closing during which, according to the agreement, the copier subsidiaries were being run in the normal course of business on Muller's account. This fund, generated before to the anticipated closing date, was accruing to Muller above and beyond the value of the assets of the subsidiaries that he

was to receive in exchange for the price that was finally to be agreed on. Given his failure to establish his own ability to perform, Muller certainly may not recover the bargained-for properties, the profit realized thereon after the would-be closing date or even the profit accruing to SCM from the sale of the properties to others. However, it would be inequitable in view of SCM's bad faith conduct from which it was able to profit so handsomely, to allow it to retain that amount which, in exchange for Muller's commitment to the deal, was to be accruing to his account even before his ability to perform was to be tested at closing.

This conclusion seems appropriate in the light of the doctrine of restitution or unjust enrichment. The remedy of restitution to prevent unjust enrichment is commonly applied both in the realm of quasi-contract and as an alternative basis for recovery upon breach of contract. *See* Restatement, *supra*, Topic 4-Restitution §§ 384, 391, and Introductory Note thereto (Tent. Draft No. 14, 1979); 5 Corbin, *supra*, §§ 1106-07. This doctrine rests, generally, upon the equitable principle that a person shall not be allowed to enrich himself at the expense of another. *Miller v. Schloss*, 218 N.Y. 400, 407, 113 N.E. 337 (1916). It is not necessarily grounded on contract or on promise but on an obligation created by law,

> when and because the acts of the parties or other have placed in the possession of one person money, or its equivalent, under such circumstances that in equity and good conscience he ought not to retain it, and which *ex aequo et bono* belongs to another.

Id.; *see Paramount Film Distributing Corp. v. State*, 30 N.Y.S.2d 415, 334 N.Y.S.2d 388, 393, 285 N.E.2d 695, 698 (1972); *Friar v. Vanguard Holding Corp.*, 78 A.D.2d 83, 434 N.Y.S.2d 698, 701-02 (2d Dep't 1980); *Eightway Corp. v. Dime Savings Bank*, 94 Misc.2d 274, 404 N.Y.S. 2d 302 (Civ.Ct. Queens Co. 1978), *aff'd*, 99 Misc.2d 989,

420 N.Y.S.2d 837 (Sup.Ct. Queens Co. 1979). An element in the equation is that the unjust enrichment of the defendant be at the expense of the claimant, and this usually necessitates a finding that a benefit was conferred by the claimant, or in other words that a benefit corresponds to a loss to the claimant. *See Nacional Financiera, S.A. v. Banco De Ponce*, 120 N.Y.S.2d 373, 415-17 (Sup. Ct. N.Y.Co. 1953); *aff'd*, 283 A.D. 939, 131 N.Y.S.2d 303 (1st Dep't 1954); 50 N.Y. Jur. Restitution § 6 (1966). However, there is case support for a finding of unjust enrichment without such a readily identifiable correspondence. *Saunders v. Kline*, 55 A.D.2d 887, 391 N.Y.S. 2d 1, 2 (1st Dep't 1977); 50 N.Y.Jur., *supra*, at 162; *see also Brooks v. Peoples' Bank*, 233 N.Y. 87, 134 N.E. 846 (1921); *Roberts v. Ely*, 113 N.Y. 128, 20 N.E. 606 (1889); *Robert Reis & Co. v. Volck*, 151 A.D. 613, 136 N.Y.S. 367 (1st Dep't 1912); Knapp, *supra*, at 724-25 n.174; *see generally* 4 Corbin, *supra*, § 979 and 5 Corbin, *supra*, § 1107.

Under the circumstances presented here where SCM had obligated itself as part of the agreements reached to run the copier subsidiaries for Muller's account from August 31, 1976 to the anticipated closing date, I conclude that to allow SCM to retain the profit earned during all of that period would be to condone unjust enrichment.[11]

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[11] The plaintiff has failed to establish the basis for promissory estoppel urged as an alternative ground for recovery.

Based on the reliance principle, the doctrine is set forth in § 90(1) of the Restatement, *supra*, (Tent.Drafts Nos. 1-7, 1973) as follows:

> A promise which the promisor should reasonably expect to induce action or forebearance on the part of the promisee or a third person and which does induce such action or forebearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

[Continued]

Whatever the theory, there would be certain logic to fashioning a recovery to encompass out-of-pocket legal and other expenditures in preparation for performance, or even the cost of forebearance (presumably the value of opportunities foregone). However, bearing in mind the flexibility of available contract remedies, *see* 5 Corbin, *supra*, § 996, since Muller is in a sense gaining the benefit of his bargain—or, at least, as much of it as he is entitled to under the circumstances—he will not at the same time recover his legal fees incurred to produce this benefit, apparently the only significant out-of-pocket expense, or any other reliance-type damages. *See* Corbin, *supra*, §§ 1034, 1036. *Cf. Gruen Industries, Inc. v. Biller*, 608 F.2d 274, 280-82 (7th Cir. 1979). I have concluded the proper remedy is the award to Muller of the profit earned by the copier subsidiaries from August 31, 1976 to February 2, 1977, the date of the repudiation.

On the basis of this opinion, a conference will be held on July 9, 1981 at 5:00 p.m. to determine whether any further hearing is required in order to enter judgment in accordance with this opinion.

IT IS SO ORDERED.

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[11] [Continued]

See Schmidt v. McKay, 555 F.2d 30, 36 (2d Cir. 1977); *James King & Son, Inc. v. DeSantis Constr. No. 2 Corp.*, 97 Misc.2d 1063, 413 N.Y. S.2d 78, 81 (Sup.Ct. N.Y.Co. 1977). *But see Swerdloff v. Mobil Oil Corp.*, 74 A.D.2d 258, 427 N.Y.S.2d 266, 268 (2d Dep't), *appeal denied*, 50 N.Y.2d 913, 431 N.Y.S.2d 523 (1980). The measure of damages under this theory would be the value of the claimant's action or forebearance in reliance, to its detriment. Such detriment may be found in forebearance from action which amounts to a change in position, in reliance on the words or deeds of the defendant. *Cf. Warren v. Hudson Pulp & Paper Corp.*, 477 F.2d 229 (2d Cir. 1973). In the commercial setting of this case, the extent of Muller's detrimental reliance might be the value of other business opportunities foregone in anticipation of the closing of this deal pursuant to the agreements already reached. *See Swerdloff, supra*, 427 N.Y.S.2d at 268-270; Goetz and Scott, Enforcing Promises: An Examination of the Basis of Contract, 89 Yale L.J. 1261, 1267-70, 1287-88 (1980). However, no such evidence has been adduced.

APPENDIX

The August memorandum reads as follows:

1. SCM to sell the stock of the German, French, Belgium and Swiss subsidiaries and the copier assets of the Chur and U.K. subsidiaries.

2. SCM shall have the right to allocate the total proceeds, assigning values to each of the four stock sales and two asset sales.

3. In no case will cash and securities be included nor will assets related to the typewriter distribution business (which is currently being separated out) be included.

4. The names of the purchased subsidiaries will be changed and the use of the SCM name and logo will be discontinued within an agreed upon time limit.

5. SCM will retain or discharge all balance sheet liabilities except those that relate to compensation and employee benefits, which will be assumed by the purchaser.

6. In the U.K., liability for employees and leases relating to the copier business will be assumed by the purchaser.

7. Goods in transit from suppliers (purchased under contract commitments and prepaid) will be reimbursed by purchaser at delivered cost rather than being included in the inventory account.

8. Purchaser will assume responsibility for performance under purchase agreements entered into by SCM for equipment and supplies for the operations to be sold.

9. New York personnel directly related to International Copier operations will be employed by purchaser.

The September memorandum reads as follows:

1. We will license use of name for three years with appropriate safeguards on its use.

2. We will warrant against undisclosed liabilities to the extent that they exceed a pool of $150,000, the purpose of which is to absorb claims not in excess of $10,000 per claim. We will have the right to dispose of claims as we see fit.

3. We will only be responsible for shortages of inventory count and then to the extent that such shortages exceed a pool equal to the inventory reserve. (time limitation)

4. We will be responsible for uncollectable receivables in excess of a pool which is to be equal to the receivable reserve plus $200,000, but not less than $500,000. We will reimburse purchaser at the rate of 53¢/$ (?) for losses in excess of the pool. (time limitation)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

77 Civ. 5705 (RWS)

REPROSYSTEM, B. V., and N. NORMAN MULLER,
Plaintiffs,

—against—

SCM CORPORATION,
Defendant.

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[Filed Sept. 18, 1981]

SWEET, D.J. Currently before the court in this action for breach of contract and related wrongs are various issues raised by the parties with regard to the recovery to be had by plaintiffs Reprosystem, B. V. ("Reprosystem") and N. Norman Muller ("Muller"), pursuant to this court's opinion of June 30, 1981, familiarity with which is assumed, and the conference held on July 9, 1981. In the prior opinion, which followed a three-week bench trial on the issue of liability, it was determined that while plaintiffs are entitled to a certain recovery due to breach of contract and failure to bargain in good faith on the part of defendant SCM Corporation ("SCM"), plaintiffs, due to their failure to establish their ability to perform, are not entitled to full expectancy damages. The issues now raised by the parties will be disposed of in accordance with this opinion.

Initially, the court has considered the arguments of the parties, on the facts as found and the law, addressed to the basis for recovery previously determined, and rejects them all. The parties urge, respectively, that recovery should be more broadly based and extensive, and that no recovery should be had under any theory. I have already observed, in the prior opinion, that neither the determination of liability nor the assignment of a proper remedy is simple on the facts of this case involving on the one hand the bad faith repudiation of a preliminary agreement for the sale of a business, and on the other hand the failure of proof by the would-be purchaser of its own ability to perform when such was to come due. While the merits of the court's opinion upon the facts found has been argued ably by the parties, nothing which has been presented convinces me that my determination of June 30 on this subject should be altered. As plaintiffs correctly point out, however, the actual, undisputed date of SCM's repudiation, by letter of Herbert Egli of SCM to Muller, was February 4, and not February 2, 1977. Thus, in accordance with the intent of my prior opinion, plaintiffs

are entitled to the profit earned by the copier subsidiaries from August 31, 1976 to February 4, 1977.

The parties' respective calculations of the profit earned by the subsidiaries during that period differ significantly, with plaintiffs estimating approximately $2 million, and SCM, approximately $1.6 million. There will be a factual hearing if necessary to be scheduled by the parties and the court and completed by September 30, 1981 with respect to any terms not resolved by this opinion.

The parties have disputed the propriety of several suggested deductions and additions to the raw profit figure. SCM's requested deduction for the profit of the United Kingdom subsidiary will be denied. While there was some evidence of reservations on plaintiffs' part with respect to the purchase of the U.K. subsidiary, the record, viewed as a whole, supports the conclusion that the purchase of this subsidiary along with the others was contemplated. Therefore, no such deduction will be allowed. The New York office expense attributable to the copier operation is a proper deduction (as recognized by plaintiffs), as is the interest cost allocated to the subsidiaries during the relevant period. However, the requested deduction for general corporate overhead has not been supported by reference to any pertinent document or agreement of the parties, and thus is unwarranted. Further, in view of the findings of this court as reflected in the opinion of June 30, there is no basis for a 49% deduction representing the share of Reprosystem not owned by Muller. Both plaintiffs were parties to the so-called Agreement in Principle and the Final Drafts with Reprosystem as purchaser.

The most heated dispute—involving the most money—is over the suggested deduction of taxes paid by the subsidiaries, and the addition of prejudgment interest on the award. Plaintiffs cite several cases which would indicate that a pre-tax profit measure is the norm in assigning damages in breach of contract and related contexts of statutory violations causing loss of profits. *L.P. Larson,*

Jr., Co. v. William Wrigley, Jr., Co., 277 U.S. 97 (1978); *Eiberger v. Sony Corp. of America*, 459 F. Supp. 1276, 1286-89 (S.D.N.Y. 1978), *aff'd in part rev'd in part*, 622 F.2d 1068 (2d Cir. 1980); *Paper Converting Machine Co., Inc. v. FMC Corp.*, 432 F. Supp. 907, 916 (E.D. Wisc. 1977), *aff'd*, 558 F.2d 832 (7th Cir. 1978); *Lee v. Joseph E. Seagram & Sons, Inc.*, 413 F. Supp. 693, 706-07 (S.D.N.Y. 1976), *aff'd*, 522 F.2d 447 (2d Cir. 1977). *See also Bloor v. Falstaff Brewing Corp.*, 454 F. Supp. 258, 277-80 (S.D.N.Y. 1978), *aff'd*, 601 F.2d 609 (2d Cir. 1979). SCM urges, with some force however, that while the "rule" of pre-tax profits may correctly apply in cases where the facts justify an award of lost profits or the like as expectation damages upon a breach of contract or similar wrong, as in the cases cited by plaintiffs, it does not apply in this case, where the award is based on a theory of disgorgement of unjust enrichment.

In the unique circumstances of this case, the court sought to fashion a remedy which, as was stated in the opinion of June 30, could be viewed as the appropriate compensation for the defendant's breach of its duty to deal in good faith, or as the appropriate measure of damages, all things considered for SCM's repudiation of the agreement reached by the parties. However, in view of plaintiffs' failure to establish their ability to perform and the consequent inappropriateness of awarding expectation damages, as previously stated, the award is justified most reasonably in terms of the doctrine of restitution or unjust enrichment.

SCM correctly points out that plaintiffs' cite no case in which a pre-tax figure was used in computing an award having such an equitable basis, and the court has discovered none. Further, while the measure of damages to which a plaintiff is entitled in the traditional breach of contract context is the amount necessary to put him in as good a position as he would have been in had the contract been performed. *Perma Research & Development Co. v.*

Singer Co., 542 F.2d 111, 116 (2d Cir.), *cert. denied*, 429 U.S. 987 (1976); *see also Marshall v. Burger King Corp.*, 509 F. Supp. 353, 356 (E.D.N.Y. 1981), the proper measure under the theory of restitution is the benefit to the defendant, the extent of the unjust enrichment. *S.S. Silberblatt, Inc. v. East Harlem Pilot Project*, 608 F.2d 28, 41 (2d Cir. 1979) ("Ordinarily an award of restitution based on unjust enrichment, unlike contract damages, is not designed to put the aggrieved party in the position where he would have been if the contract had been performed but to restore him to the *status quo ante*, regardless of the contract price or rate."); *Naimoli v. Massa*, 81 Misc.2d 431, 366 N.Y.S.2d 573, 578 (City Ct. Geneva 1975). *Compare, Turnkey Proposals, Inc. v. Rose*, 57 A.D.2d 949, 395 N.Y.S.2d 96, 97 (2d Dep't 1977) ("[e]ven if recovery were to be based upon *quantum meruit*, since there was substantial performance on the part of the plaintiff, the proper measure of damages would still be the contract price [citation omitted]."). Thus, borrowing the traditional unjust enrichment analysis, it would be inappropriate for SCM to have to disgorge to plaintiffs a sum representing taxes paid on the profits which this court has held SCM unjustly retained. This deduction for taxes will be allowed.

Finally, in view of the equitable nature of the relief granted, in the exercise of my discretion, I decline to award pre-judgment interest. *Bosco v. Alicino*, 37 A.D. 2d 552, 322 N.Y.S.2d 414 (1st Dep't 1971); C.P.L.R. § 5001(a).

IT IS SO ORDERED.

/s/ Robert W. Sweet
ROBERT W. SWEET
U.S.D.J.

DATED: New York, N.Y.
September 15, 1981

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

77 Civ. 5705 (RWS)

REPROSYSTEM, B. V., and N. NORMAN MULLER,
Plaintiffs,

—against—

SCM CORPORATION,
Defendant.

APPEARANCES:

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By: PETER FLEMING, JR., ESQ.
BRADLEY TYLER, ESQ.
Of Counsel

SWEET, D. J. Over a year after the close of testimony in this action issues still remain relating to the calculation of damages, despite the opinions of this court filed on June 30, 1981 and September 15, 1981. The diligence and skill of counsel has served again to illuminate the complications presented in determining the appropriate damages to be awarded to the purchaser of a multimillion dollar business when the transaction is improperly terminated. Familiarity with the opinions previously filed and the lexicon of the litigation is assumed.

Based upon the hearing conducted on March 5, 1982, and the submissions of the parties I conclude that, absent an agreement between the parties, a further evidentiary hearing will be required to determine the amount of taxes paid by the German and French subsidiaries allocable to the period August 31, 1976 to February 4, 1977, which would serve to reduce the profits earned by those subsidiaries. In addition, the plaintiffs Reprosystem B. V. and N. Norman Muller (collectively "Muller") challenge the proof concerning actual transactions completed during the relevant period upon which the net currency conversion loss is based. A hearing on this issue also thus required.

Following the schedule which has been presented by the defendant SCM Corporation ("SCM"), I understand that the accounting adjustments for August 1976 fiscal and August 1976 calendar and to include the period from the end of fiscal year 1976 to February 4, 1977 can be agreed upon.

As is indicated from what has been set forth, actual taxes paid by the subsidiaries will serve to reduce income, as well as taxes which can be demonstrated to be attributable to the period at issue, but no credit will be allowed for taxes paid on profits upstream to SCM. The tax consequences upon the subsidiaries will be left where they originated. The same reasoning will apply to any corporate assessment calculation which will be disallowed

unless such an assessment appears on the records for the relevant period or can be reconstructed in accordance with the practice employed in 1975, if such there be.

As for item D, other income or expense, this adjustment turns upon the net currency loss, referred to above, upon which a further hearing will be required, and the interest earned by the German subsidiary attributable to the "Canadian note," an issue which was considered by the parties as the understanding concerning the transaction was eroding early in January, 1979. It was not resolved in 1977 and without proof that the appropriate book entries reflecting the treatment sought by SCM were made during the relevant period, the adjustment will be disallowed. The converse, of course, is equally applicable.

No adjustments will be made based on the "might-have-beens" of the Mita transactions, or additional New York expense attributable to the negotiations including the fees and disbursements of Sullivan and Cromwell. No interest adjustment will be made other than that which can be demonstrated as having been made in the normal course during the period in question, or calculated in the same manner as any such deduction taken on the books of the subsidiaries at the end of fiscal 1975.

These determinations have been required because of the need to establish the profits of the subsidiaries during the period from August 31, 1976 to the termination of the discussions, during which period the subsidiaries were to be operated in the normal course and for Muller's benefit. Of course, this calculation was never made during the period, hence the present difficulty. It is an effort to disgorge profits improperly acquired by SCM and to which Muller is entitled, even though because of SCM acts he was never required to tender the purchase price.

The artificiality of the calculation is underlined when the tax consequences are considered. I have already concluded that any taxes paid by the subsidiaries should

be deducted from the profit calculation for the reasons just set forth. However, with their customary skill and diligence counsel for Muller have argued that not only is the credit unwarranted but that payment of the judgment will provide a tax credit, a benefit to SCM which should also be turned over to Muller to prevent SCM from benefitting from its improper conduct. Some authority has been cited for the proposition, which has some persuasive effect particularly given the equitable nature of the relief sought to be granted.

Perhaps the clearest exposition of Muller's theory in the cases is set forth in *Schnadig Corp. v. Gaines Mfg. Co.*, 620 F.2d 1166, 1169-71 (6th Cir. 1980) where in a patent infringement case the court concluded that "total profits" under the statute required the award of pre-tax profits, principally because of the effect of what Muller has termed here the judgment tax benefit. However, the court noted that the award was made under a statutory provision rather than as a recovery under the common law. *See also MacBeth-Evans Glass Co. v. L. E. Smith Glass Co.*, 23 F.2d 459, 463 (3d Cir. 1927) (patent action); *W. W. Sly Mfg. Co. v. Pangborn Corp.*, 276 F. 971, 977 (D.Md. 1921), *aff'd*, 284 F. 217 (4th Cir. 1922) (patent action).

Yet from a practical effect consideration of the judgment tax benefit urged by Muller would appear to be a legal trompe l'oeil, an ever receding calculation into infinity as each successive tax credit was made available to the winning party. True, of course, the process could be stopped at any rational point, such as after the first credit is turned over to the prevailing party, yet the process points out the difficulty of altering the effect of future tax liability as a consequence for a present judgment say nothing of the difficulty in resolving the amount, if any, of such a tax credit. The judgment tax credit will not be allowed.

Similarly, decisions that have included an inflation factor in damage calculations have generally been limited to cases involving the present value of future wages, medical expenses and pain and suffering. *See, e.g., Doca v. Marina Mercante Nicaraguense*, 634 F.2d 30, 34-40 (2d Cir. 1980), *cert. denied*, 451 U.S. 971, 101 S.Ct. 2049 (1981) (lost future wages); *Espana v. United States*, 616 F.2d 41, 44 (2d Cir. 1980) (future medical expense and future pain and suffering); *Dullard v. Berkeley Assoc. Co.*, 606 F.2d 890, 896 (2d Cir. 1979) (wrongful death award; future earning capacity); *Steckler v. United States*, 549 F.2d 1372, 1375-78 (10th Cir. 1977) (future earnings); *Feldman v. Allegheny Airlines, Inc.*, 524 F.2d 384, 387 (2d Cir. 1975) (wrongful death; future earning capacity). No proof has been adduced on this subject—nor is it invited. Here again, the suggestion is appealing, and in some other circumstance or at some other level of determination it may be required, but in the exercise of my discretion and in the absence of any authority granting such relief in a commercial transaction, I decline to adjust Muller's recovery to give effect to inflation.

One underlying reason for my reluctance to adopt Muller's well thought out and interesting suggestions for calculating additional damages has been previously stated in my denial of prejudgment interest. Since Muller was never required to tender the purchase price, he has not been deprived of the use of his funds since the termination of the negotiations. Further, had the transaction gone forward, it is impossible to determine how the subsidiaries would have fared under Muller's management and whether the profits earned during the relevant period would have survived for either tax or inflation purposes. I suspect the ingenuity of counsel has been exercised to compel me, *sub silentio*, to review the decision already reached, the denial of prejudgment interest, which if granted could well have substituted for the requested

judgment tax and inflation credits. I now do so, and conclude under all the circumstances, all known to the parties and set forth elsewhere, in the exercise of my discretion, that neither the prejudgment interest nor the requested credits are appropriate for inclusion in the damages.

If the parties are able to agree upon a damage calculation in the light of this opinion, a judgment will be settled upon notice. If not, a further hearing will be held on May 15 or such other date as is convenient for counsel and the court.

IT IS SO ORDERED.

/s/ Robert W. Sweet
ROBERT W. SWEET
U.S.D.J.

DATED: New York, N.Y.
March 31, 1982

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

77 Civ. 5705 (RWS)

REPROSYSTEM, B. V. and N. NORMAN MULLER,
Plaintiffs,

—against—

SCM CORPORATION,
Defendant.

APPEARANCES:

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Of Counsel

[Filed Sept. 13, 1982]

SWEET, D.J. A post trial hearing was conducted on June 2, 22 and July 1, 1982 at which evidence was presented with respect to the calculation of damages to be awarded by way of judgment in favor of plaintiffs Reprosystem B, B.V. ("Reprosystem") and N. Norman Muller ("Muller") against deefndant SCM Corporation ("SCM"). Judgment will be entered in accordance with this memorandum opinion on notice within ten (10) days of the date hereof.

Prior Proceedings

On June 30, 1981 an opinion was filed which determined the liability issues raised in Reprosystem's action against SCM arising out of SCM's failure to transfer its European copier assets to Reprosystem. Certain issues as to the calculation of damages remained outstanding and a further opinion was issued on September 15, 1981 on that subject. The effect of taxes on the damages calculation became a principal issue, since the judgment to be entered sought to award Reprosystem the profit which SCM had garnered by its conduct, held to be a breach of its duty. The difficulty, of course, arose because the transaction upon which Reprosystem sued did not in fact take place, and the tax effect on the theoretical transaction became more difficult to determine. Reprosystem sought recovery for pre-tax profits, while SCM urged that the post tax profits constituted the proper measure of damages under the June opinion.

The September 15, 1981 memorandum opinion sought to deal with the issue by stating:

> Thus, borrowing the traditional unjust enrichment analysis, it would be inappropriate for SCM to have to disgorge to plaintiffs a sum representing taxes paid on the profits while this court has held SCM unjustly retained. This deduction for taxes will be allowed.

As subsequent events have established, "taxes paid" became as difficult to determine as a consequence of the change in circumstances and the difference between tax treatment in the United States and Europe as the original liability issues had been.

Discovery was conducted, a hearing was held and on March 31, the court issued yet another memorandum opinion on the subject of damages and taxes, concluding that a factual hearing would be required to establish the amount of German and French taxes paid attributable to the period as well as the effect of certain currency transactions. Reprosystem's claim that SCM should also pay over a judgment tax was rejected. More discovery took place, and a final hearing was held on June 2, 22 and July 1, 1982 as recounted above.

By and large the amount of gross profits for the period in question have been determined. These amounts will be affected by the treatment to be accorded the following items.

(1) the $25,107 attributable to income of the Chur.

(2) The $191,000 adjustment to the profits of its French subsidiary for the period from August 25 to August 31, 1976 ("the French adjustment").

(3) The $171,000 interest accrued to the German subsidiary as a result of the intercompany loan to the Canadian subsidiary ("the Canadian transaction").

(4) Foreign currency adjustments.

(5) The $55,000 attributable by SCM to a corporate assessment ("the SCM corporate assessment").

(6) The $196,000 SCM claims is payable and therefore deductible on the assets of the foreign subsidiaries ("the SCM interest").

(7) The tax deductions for

(a) United Kingdom and Belgium.

(b) Chur

(c) Switzerland

(d) Germany

(e) France

As to the overall income calculation, I conclude on the evidence submitted that Chur subsidiary profits were mistakenly overstated by $25,107.

The French adjustment of $191,000 must be determined on the basis of the allocation of the burden of proof. The change betwen the August 25 and 31 figures is dramatic and is based solely upon a one-page revision without any evidence adduced from books of original entry. However, this revision went unchallenged by Reprosystem's accountants in the fall of 1976, and no direct evidence has been adduced to support a conclusion, urged by Reprosystem, that the revision was unjustified. Although there is evidence that the treatment given by SCM is atypical, there has been no direct challenge to the original records which have been produced. Contrary to Reprosystem's contentions, I conclude that the burden of proof did not shift after the decision on liability was reached and that the plaintiffs have failed to establish that the SCM revision was other than what it was represented to be, either in 1976 or today. Were more evidence available, the result might well be otherwise.

The Canadian transaction resulted when the German subsidiary accrued interest on a loan which it had made to the Canadian SCM subsidiary. Regardless of how this asset would have been treated upon the completion of the transaction, in the meantime, interest, either paid or accrued by a subsidiary, was an appropriate item for profit determination and was so considered by SCM with

respect to all other interest items. This reduction in income was first raised by SCM after Egli's year end examination and was not explained satisfactory to Reprosystem in January, 1977. Consistency requires that the Canadian interest be added to the income of the German subsidiary. A concomitant of the determination on the Canadian transaction is that any currency adjustment for such a transaction must also be allowed as well as the $17,000 conceded by Reprosystem.

The corporate assessment and the SCM interest were never paid by the subsidiaries and were SCM adjustments rather than entries on the subsidiaries' books. These deductions are not appropriate in this context, for there is no evidence that they would have been made had the transaction gone forward.

No taxes claimed by SCM were actually paid by the United Kingdom, Belgium or Chur subsidiaries and therefore none are deductible from the profits of those subsidiaries. As to Switzerland, SCM has failed to establish that taxes were paid or that reserves for taxes were established on the books of the subsidiary during the relevant period.

The problem is heightened with respect to France and Germany where no taxes were actually paid during the period, but rather were paid or assessed at a later period. To fix the amount of tax attributable to the damage period becomes a theoretical calculation which varies depending on whether United States, French or German accounting principles are applied, what taxes are considered, and even which books of account are to be employed.

Since it was contemplated that Reprosystem would take over the French and German subsidiaries, less the typewriter assets, the tax liability for the period when ultimately decided, would have served to reduce its profit. Reprosystem has adduced no testimony to conflict with

that presented by SCM as to the tax liability which would have ultimately accrued for the German and French subsidiaries during the damage period and the SCM calculation for German taxes paid will be employed in calculating damages.

With respect to the French subsidiary the taxes paid for fiscal 1977 are known and can be attributed mathematically to the damage period. What appears to be at issue is the profit calculation against which this deduction is to be made. This figure should be calculated in the same fashion that was employed in the preparation of the "flash reports" and adjustments for profits earned agreed upon by the participating parties during the damage period.

Submit judgment on notice within ten (10) days.

IT IS SO ORDERED.

/s/ Robert W. Sweet
ROBERT W. SWEET
U.S.D.J.

DATED: New York, N.Y.
August 27, 1982

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

77 Civ. 5705 (RWS)

REPROSYSTEM, B. V., and N. NORMAN MULLER,
Plaintiffs,

—against—

SCM CORPORATION,
Defendant.

APPEARANCES:

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BRADLEY TYLER, ESQ.
Of Counsel

[Filed Dec. 23, 1982]

SWEET D.J. Yet another memorandum opinion is required on the subject of damages in the context of judgments proposed by the parties. Familiarity with past orders, opinions and terminology used by the parties and the court is assumed.

The most meaningful item in contention is the $448,000 which according to SCM represents the currency adjustment which would have been required by its German subsidiary with respect to the intercompany loan to the Canadian subsidiary. Of course, this is a non-copier asset and as such, would not have been part of the transaction, had it gone forward. According to the affidavit submitted by SCM in support of its proposed judgment and its previously submitted supplemental memorandum on damages:

> . . . SCM properly accounted for these transactions in accordance with its own internal procedures and with generally accepted accounting principles. Further, SCM properly accounted for these transactions within the context of the damages calculation in that they did not credit the plaintiff with the interest income earned by the non-copier assets nor did they charge the plaintiff with the expense of currency devaluation.

In my last effort to reconstruct the profit determined to be owed Reprosystem, I included the Canadian interest based upon the SCM treatment of interest as an income item, had the funds remained in Germany, and the difficulty of determining whether the source of the funds were indeed copier assets. In my August 27, 1982 opinion, I also recognized the concommitant effect of any currency adjustment applicable to the Canadian transaction. Of course, these determinations were reached against a background which includes the parties' inability to understand or agree upon these items at the time of the discussions in January, 1977 when the Canadian transaction first came under consideration.

Because I have previously found that the parties intended the copier business of the subsidiaries to be run for Reprosystem's benefit during the period in question, I now conclude that my decision of August 27, 1982 with respect to the Canadian transaction and the treatment of the interest income was in error, particularly when the skewing effect of the one-time currency adjustment is considered. In the absence of any contemporaneous evidence as to the treatment of the income from the Canadian loan or as to the date for any currency adjustment, and finally, considering the uncertainty as to the copier source of funds, I now conclude that the interest on the Canadian loan and the currency adjustment both should be excluded from the calculations.

The $35,000 difference between the parties with respect to currency conversion results from a theoretical adjustment which SCM seeks to apply to assets not disposed of during the relevant period, but which it maintains should be devalued thus creating a loss which would reduce the profit owing to Reprosystem. It must be assumed that had the transaction gone forward, the valuation of the assets to be disposed of would have been adjusted by any required currency conversion thus affecting Reprosystem's profit during the relevant period. Again, of course, the evidence does not reveal what happened but points to the practice which would have been adopted. Reprosystem has pointed to no evidence to offset what is alleged to be SCM's standard accounting practice in the regard. The profit will thus be reduced by $35,000 as urged by SCM.

The German taxes paid calculation of SCM is $249,000 and Reprosystem urges that the correct figure is $235,000. The difference between the two amounts is principally the inclusion of the audit adjustment payment (a subsequently determined adjustment to the previously calculated tax) and a trade tax and capital tax not previously considered. Of course, these adjustments were not taxes paid during the period but they are accurate statements

of taxes payable for the period. As such, I consider them proper deductions and therefore the final judgment will be determined on the basis of SCM's calculations for the German taxes paid.

No change is warranted in SCM's calculation for taxes paid in France. Also, the matter of pre-judgment interest has previously been determined against Reprosystem.

Thus judgment will be entered on the following basis:

	Total profits earned by copier companies September 1, 1976 to February 4, 1977	$1,708,000
less	New York expenses	131,000
less	"Taxes paid" by German subsidiary	249,000
less	"Taxes paid" by French subsidiary	266,000
	Total	$1,062,000

Judgment to be entered in accordance with this latest, and hopefully last, memorandum on this issue.

IT IS SO ORDERED.

/s/ Robert W. Sweet
ROBERT W. SWEET
U.S.D.J.

DATED: New York, N.Y.
December 22, 1982

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

77 Civ. 5705 (RWS)

REPROSYSTEM, B. V., and N. NORMAN MULLER,
Plaintiffs,

—against—

SCM CORPORATION,
Defendant.

JUDGMENT

This action having come on for trial before the court, Honorable Robert W. Sweet, District Judge, presiding, and the issues having been duly tried on trial days including January 12, 13, 14, 15, 16, 20, 21, 22, 23, 26, 27, 28, 29 and 30, 1981; February 2, 3, 4, 5, 6, 9 and 10, 1981; June 2 and 22, 1982; and July 1, 1982, and decision thereon having been duly rendered, including decisions dated June 30, 1981, September 15, 1981, March 31, 1982, and August 27, 1982,

IT IS ORDERED AND ADJUDGED that the plaintiffs Reprosystem, B.V. and N. Norman Muller recover of the defendant SCM Corporation the sum of ONE MILLION SIXTY-TWO THOUSAND ($1,062,000.00) DOLLARS computed as follows:

	Total profits earned by copier companies September 1, 1976 to February 4, 1977	$1,708,000
less	New York expenses	131,000
less	"Taxes paid" by German subsidiary	249,000
less	"Taxes paid" by French subsidiary	266,000
	Total	$1,062,000

and that plaintiffs recover interest thereon at the rate of Nine Percent (9%) per annum as provided by law from the entry date of this judgment, together with the costs of this action.

AND IT IS FURTHER ORDERED AND ADJUDGED that the defendant's counterclaim against plaintiffs be dismissed on the merits and with prejudice.

DATED: New York, N.Y.
December 22, 1982

/s/ Robert W. Sweet
ROBERT W. SWEET
U.S.D.J.

Judgment entered 12/23/82

RAYMOND F. BURGHARDT
Clerk

APPENDIX C

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), provides as follows:

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. § 240.10b-5 (1983), provides as follows:

§ 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

No. 83-1966

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

REPROSYSTEM, B.V., and N. NORMAN MULLER,

Petitioners,

v.

SCM CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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July 1, 1984

* *Counsel of Record*

Counterstatement Of The Question Presented

Should the implied right of action which has been recognized under Section 10(b) and Rule 10b-5 be expanded to apply to negotiations for the purchase and sale of securities where those negotiations do not result in a contract of purchase and sale and no securities are purchased or sold?

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

REPROSYSTEM, B.V., and N. NORMAN MULLER,

Petitioners,

v.

SCM CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

Respondent SCM Corporation ("SCM")[1] respectfully requests that this Court deny the petition for a writ of certiorari seeking to review the judgment of the United States Court of Appeals for the Second Circuit entered on February 2, 1984.

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1 Pursuant to Rule 28.1 of this Court, SCM states that it has no parent or affiliates; its subsidiaries (other than wholly-owned subsidiaries) are: Pinturas Ecuatorias, S.A., Distribuidora Americana, C.A., Pinturas Centro-Americanas, S.A., Glidden de Honduras, S.A., Galvanizadora Centro-Americana, S.A., Compania Agricola Myristica, S.A., and Pinturas Centro-Americanas Costa Rica, Ltda. (all subsidiaries of SCM-Glidden International Co.).

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 727 F.2d 257 (2d Cir. 1984) and is reprinted in the Appendix filed by petitioners at 1a-16a.[2] The opinion of the District Court for the Southern District of New York, reported at 522 F. Supp. 1257 (S.D.N.Y. 1981), is reprinted in the Appendix at 17a-68a.[3]

STATUTE AND REGULATION INVOLVED

The statute and regulation which petitioners claim are involved are Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982) ("Section 10(b)") and Rule 10b-5, 17 CFR § 240.10b-5 (1983) ("Rule 10b-5"), promulgated thereunder by the Securities and Exchange Commission.[4]

STATEMENT OF THE CASE

Between May 1976 and early February 1977, SCM and N. Norman Muller ("Muller") engaged in negotiations for the purchase of SCM's European copier businesses by Reprosystem, B.V. ("Reprosystem"), a Netherlands Antilles corporation to be formed by Muller. After SCM withdrew from the negotiations in February 1977, Muller and Reprosystem brought an action against SCM seeking money damages.

Muller and Reprosystem alleged that a contract of purchase and sale was reached in December 1976 and that SCM breached that contract by refusing to sell the businesses.

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2 References in the form "Appendix ____" refer to pages of the Appendix filed by petitioners.

3 The Appendix also contains four opinions of the district court relating to the calculation of damages. (Appendix at 69a-89a.) None of those opinions have any bearing upon the purported federal securities law claim alleged here.

4 Section 10(b) and Rule 10b-5 are reprinted in the Appendix at 92a-93a.

Additional state law claims were pleaded based upon allegations of promissory estoppel, unjust enrichment, a failure to perform and negotiate in good faith, and common law fraud. To support federal jurisdiction, petitioners also included a claim for purported securities fraud under Section 10(b) and Rule 10b-5.

In its initial opinion, dealing primarily with liability (522 F. Supp. 1257), the district court quickly disposed of petitioners' federal and common law fraud claims, finding that SCM's conduct and its refusal to sign the contract drafts were "motivated not by an intent to defraud or deceive, but simply out of careful financial analysis not rising to the level of fraud under the securities laws or common law." (522 F. Supp. at 1273).[5]

The district court then turned to the heart of the case as it had been presented at trial—whether Muller and Reprosystem were entitled to recover damages on their breach of contract claim. SCM argued: (i) that a binding agreement was never reached; (ii) that the parties moreover had in fact agreed not to be bound to performance absent the execution of a written contract, and it was undisputed that no contract had been signed; and finally, (iii) that petitioners were unable to perform the "contract" which they claimed had been formed by the December drafts.

The district court concluded that the incomplete and unexecuted December drafts constituted enforceable contracts for the purchase and sale of SCM's copier operations (522 F. Supp. at 1271), but found also that Muller and Reprosystem were financially unable to perform on their part. (*Id.* at 1273, 1279 and 1281.) Despite this finding that petitioners could not perform whatever "contract" may have existed, and despite its additional finding that petitioners' inability to perform pre-

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5 The district court also rejected the securities fraud claim on the basis of the "sale of business doctrine." (522 F. Supp. at 1273-74.) On the other hand, the Second Circuit upheld the dismissal of the securities fraud action but took pains to point out that it did not rely upon the sale of business doctrine as a ground for its affirmance. (727 F.2d at 265.)

cluded any award of contract damages under applicable state law (522 F. Supp. at 1280-1281), the district court nonetheless held that SCM's breach of wholly undefined "duties and obligations perhaps not previously perceived or articulated as such" (*id.* at 1273) entitled Muller and Reprosystem to relief and awarded damages in "light of the doctrine of restitution or unjust enrichment". (*Id.* at 1281.)

Applying New York law, the Second Circuit reversed the district court's determination that a contract of purchase and sale had been formed.

> In this case the trial judge determined that the parties intended to be bound by the unexecuted "final drafts" and did not intend their contractual obligation to be contingent upon their final signed contracts. (727 F.2d at 260.)
>
> * * *
>
> Our review of the entire record leaves us with the definite and firm conviction that a mistake was made by the district court . . . The uncontested evidence clearly establishes the parties' intent not to be bound prior to execution of formal contracts . . . (727 F.2d at 261-262.)
>
> * * *
>
> Since the parties intended not to be bound prior to execution of those written documents and since no contract was ever executed, no written contract came into existence . . . Our conclusion that no contract existed eliminates the only basis on which [the District Court] awarded damages to [petitioners]. (727 F.2d at 263.)[6]

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6 The Second Circuit also rejected the argument that the damage award could be sustained on the theory of unjust enrichment since Muller and Reprosystem made no investment, assumed no risk, and conferred no benefit upon SCM. There was nothing "unjust about SCM retaining profits from SCM's businesses run by SCM's management at SCM's expense." (727 F.2d at 264.)

Having concluded that SCM had not entered into a contract of purchase and sale, the Second Circuit went on to hold that the "purchase or sale" requirement of *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952), therefore had not been satisfied, and affirmed the district court's dismissal of petitioners' 10b-5 claim.[7] (727 F.2d at 265.)

REASONS FOR DENYING THE WRIT

I.

NO LAW OR POLICY SUPPORTS PETITIONERS' UNIQUE CONTENTION THAT APPLICATION OF SECTION 10(b) AND RULE 10b-5 SHOULD BE EXPANDED TO REACH UNSUCCESSFUL NEGOTIATIONS FOR THE PURCHASE AND SALE OF SECURITIES

A private damage action under Section 10(b) and Rule 10b-5 is limited to those who are actual purchasers or sellers of securities. *Birnbaum v. Newport Steel Corp., supra; Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975). Because, as the Second Circuit found, plaintiffs "were not and do not claim to be actual purchasers or sellers of SCM stock" (727 F.2d at 265), the *Birnbaum* rule bars Muller and Reprosystem from maintaining an action under Section 10(b) and Rule 10b-5.[8] And, even assuming this Court were to determine that Section 10(b) and Rule 10b-5 apply to contracts for the purchase or sale of large blocks or all of the stock of a closely held corporation, petitioners "fall outside even that enlarged class of persons" (727 F.2d at 265) because of the conceded absence of a contract to purchase or sell anything.

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7 The Court of Appeals also affirmed the district court's dismissal of petitioners' other state law claims including their claim of common law fraud. (727 F.2d at 265.)

8 In their petition, plaintiffs make no statement to rebut this determination.

Muller and Reprosystem ask this Court to ignore *Birnbaum* and to create a new and troublesome implied federal cause of action by extending the scope of Section 10(b) and Rule 10b-5 to negotiations for the purchase and sale of stock even when no contract is formed and no stock sold. Petitioners say that the creation of this new federal claim is supported by "the logic of *Blue Chip Stamps*". (Petition, p. 15).

Nothing in *Blue Chip Stamps* supports the petitioners' contention that "Rule 10b-5 should apply to face-to-face negotiations for the purchase of a security regardless of whether a contract is formed." (Petition, p. 17.) In *Blue Chip Stamps,* this Court stated that "*Birnbaum* was rightly decided" (421 U.S. at 731) and explicitly held that a private damage action under Rule 10b-5 is confined to actual purchasers and sellers of securities.

Nor is it necessary or desirable to expand the application of Section 10(b) and Rule 10b-5 "to ensure the integrity of the negotiation process." More than adequate protection against improper conduct during a contract negotiation is provided by the multiple remedies available under state law. What this Court noted in *Blue Chip Stamps* is applicable here:

> "[I]n *Birnbaum* itself, while the plaintiffs found themselves without federal remedies, the conduct alleged as the gravamen of the federal complaint later provided the basis for recovery [under] state law." (421 U.S. 739 n. 9).

The petition should be denied for these reasons alone.

II.

NO ISSUE OF RECURRING IMPORTANCE HAS BEEN PRESENTED

The petition raises no issue of recurring or sufficient importance such as to warrant consideration by this Court. Petitioners present no support for their essential proposition that this case raises "a recurring issue of considerable importance to the integrity of negotiations for stock sales." (Petition, p. 19.) They cite no case, and we have found none, in which any other litigant has discerned a federal securities law claim based on negotiations which do not result in an agreement of purchase and sale. Nor do they demonstrate a need for more federal remedies in addition to the multiple state law remedies, including breach of contract, promissory estoppel, unjust enrichment and bad faith dealing, which are more than adequate and which were pleaded as pendent claims in this case. Nor has there been any inkling from Congress, the SEC, or the courts that the federal securities laws should be expanded to apply to unsuccessful negotiations. In short, this is simply another case in which a litigant seeks access to a federal court on an attenuated and contrived federal claim when, in fact, the matters in dispute arise out of, and eventually are tried and decided upon, state common law theories of liability.

CONCLUSION

The petition for a writ of certiorari should be denied. Additionally, because the question presented by petitioners is fallacious and because the petition is frivolous, respondent asks that it be awarded double its costs and reasonable attorneys' fees incurred in opposing the petition. Supreme Court Rule 57.7; *Roadway Express, Inc. v. Piper,* 447 U.S. 752, 766 (1980); *cf.* Federal Rules of Civil Procedure, Rule 11.

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July 1, 1984

No. 83-1966

IN THE
Supreme Court of the United States
OCTOBER TERM, 1983

REPROSYSTEM, B.V., AND N. NORMAN MULLER;
Petitioners,
v.
SCM CORPORATION,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

Petitioners contend that where fraud occurs in the course of face-to-face negotiations for the purchase of securities, the defrauded party should not be required to demonstrate the existence of a contract in order to sue under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1983). Petitioners demonstrated that this conclusion is consistent with (1) the underlying reasoning of *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975); (2) this Court's identification in *Blue Chip Stamps* of the "[t]hree principal classes of potential plaintiffs" that lack standing pursuant to that

case, *id.* at 737; and (3) the evolution of the common law tort of misrepresentation and deceit as described by the Court in *Blue Chip Stamps.* Petitioners also pointed out that the magnitude and number of individually negotiated transactions, the opportunities for fraud in this context, and the absence of other effective remedies supported the recognition of standing. Respondent SCM Corporation has totally failed to rebut—or even to address—petitioners' arguments.

Instead, respondent simply reiterates the simplistic position of the court below that the existence of a contract under state law is a prerequisite to any suit for fraud under the federal securities laws. This view is not compelled by the language of the statute (which does not even use the word "contract"), by the legislative history (which indicates a broad intent to eliminate fraud in the disposition of securities),[1] or by the internal logic of *Blue Chip Stamps* and *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied,* 343 U.S. 956 (1952) (which sharply distinguish between "public" offerings and face-to-face negotiations).[2]

Most importantly, respondent's view that the scope of section 10(b) is precisely delineated by the scope of state contract law reduces the antifraud provision to a mere superfluity. Under respondent's analysis, an individual is protected when he can show the existence of a contract—and therefore has all the protections of state contract law. But where fraud in the course of negotia-

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[1] *See* Petition at 15-16 & n.18.

[2] *See* Petition at 15 n.17.

Respondent, despite its heavy reliance on *Birnbaum,* failed to respond to petitioners' point that, at the time *Birnbaum* was decided, "the rule . . . was thought to relate only to public sales of securities . . . ." Eason v. General Motors Acceptance Corp., 490 F.2d 654, 658 (7th Cir. 1973) (Stevens, J.), *cert. denied,* 416 U.S. 960 (1974).

tions prevents the formation of a contract and causes other injury, the individual is left without a federal remedy.

The potential danger in this interpretation is well illustrated by *Northland Capital Corp. v. Silver*, 1984 Fed. Sec. L. Rep. (CCH) ¶ 91,496 (D.C. Cir. May 25, 1984), a case not cited by respondent. In *Northland*, as in this case, an individually negotiated securities transaction went awry just at the point of closing. The purchaser alleged that it had provided funds to the seller on the basis of forged financial statements and had received worthless securities in exchange. The *Northland* majority, invoking the same rigid interpretation of *Blue Chip Stamps* applied in this case, reasoned that, because there was no meeting of the minds of the parties and hence no contract under state law, plaintiff had no standing to sue under the federal securities laws.

One member of the *Northland* panel (Wald, J.) dissented vigorously. Not only did she disagree with the majority's analysis of state contract law, 1984 Fed. Sec. L. Rep. (CCH) ¶ 91,496 at 98,465,[3] but, more important, she criticized the majority for extending *Blue Chip Stamps* to shield "from the investor protection provisions of the Securities Exchange Act the very kind of fraudulent conduct which was a core concern of the drafters," *id.* at 98,464. The dissent noted that the holding and logic of *Blue Chip Stamps* had been ignored by the majority's overzealous invocation of state contract law principles:

> The stated purpose of *Blue Chip's* adoption of the *Birnbaum* standing doctrine was the prevention of 'strike suits' and the elimination of private damage

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[3] Hence, this type of case presents the anomaly of federal judges disputing the interpretation of state contract law in order to determine the existence of standing to sue for fraud under the federal securities laws.

> actions that would require a treacherous inquiry into the plaintiffs' subjective decisions regarding whether to invest or sell. *See* 421 U.S. at 740, 746.
>
> In this case, by contrast, Northland obviously does not fall within any of the three classes of plaintiffs that *Blue Chip* sought to eliminate.

Id. at 98,466.

The heart of *Blue Chip Stamps*, Judge Wald observed, was the Court's "balancing of the injuries that would flow from including or excluding nonsellers and nonpurchasers from the Rule's protection." *Id.* at 98,466-67 (footnote omitted). While the *Northland* majority's use of state contract law to preclude standing had "the 'disadvantage' of 'prevent[ing] some deserving plaintiffs from recovering damages that in fact have been caused by violations of Rule 10b-5[,]' 421 U.S. at 738," it had "none of the 'countervailing advantages' of . . . preventing 'strike suits' and litigation turning on subjective proof of what a plaintiff would have done in a hypothetical situation . . . ." *Id.* at 98,467. Consequently, the dissent concluded that the plaintiff in *Northland* had standing under the antifraud provisions of the federal securities laws.

Respondent's glib assertions notwithstanding, *Northland* thus demonstrates the importance and the recurring nature of the question presented by this petition.[4] It illustrates the opportunities for fraudulent conduct to occur in individually negotiated securities transactions prior to the formation of a contract. Moreover, *Northland* is yet another example of an appellate court requiring strict compliance with state contract law as a predicate for stating a federal securities claim—even though none of the concerns of the *Blue Chip Stamps* majority

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[4] "This case presents a recurring issue . . . under the federal securities laws." Northland Capital Corp. v. Silver, 1984 Fed. Sec. L. Rep. (CCH) ¶ 91,496 at 98,456.

are present. The dissent in *Northland* thus evidences the growing perception that federal appellate courts are far exceeding the logical limits of the *Blue Chip Stamps* opinion.

Respondent SCM also argues that there is no need for federal securities law coverage in this case because sufficient protection against fraud exists under state law. Brief in Opposition at 6. This argument proves too much for, under this view, a federal antifraud statute would not have been necessary at all. Congress was well aware of the existence of such state law remedies when it enacted the antifraud provisions of the federal securities laws. *Cf. United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 868 (1975) (Brennan, Douglas & White, JJ., dissenting) ("Congress contemplated concurrent state and federal regulation in enacting the securities laws."). Where, as here, state law remedies have proven inadequate to protect against fraud in connection with the sale of securities, the federal statute was designed to provide an alternative and more efficacious remedy.[5]

The question raised by this petition is thus both substantial and recurring. Moreover, it will assume even greater importance if this Court concludes, in *Vista Resources, Inc. v. Seagrave Corp.*, 710 F.2d 95 (2d Cir. 1983), *cert. granted*, 52 U.S.L.W. 3827 (U.S. May 14, 1984) (No. 83-1084), that the federal securities laws apply to sales of large blocks, or all, of the stock of a business. As petitioners have noted, the reasons why the securities laws should be applied to such negotiated

[5] In its brief, respondent cites the district court's finding that SCM's conduct in its negotiations with petitioners was not fraudulent but arose "simply out of [a] careful financial analysis." Brief in Opposition at 3 (quoting 522 F. Supp. at 1273). Not only is this finding suspect as a matter of law, but, significantly, the Second Circuit refrained from affirming the district court on this point. The court of appeals instead based its holding with respect to petitioners' federal securities law claims solely on its interpretation of Birnbaum v. Newport Steel Corp. *See* 727 F.2d at 265.

transactions are the very reasons why standing should be found in this case.

For the foregoing reasons, the petition for certiorari should be granted.

Respectfully submitted,

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